

**Debt and Coalitions:
Domestic Politics and Sovereign Borrowing**

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Dedication

Für meine Eltern.

Danke für die Wurzeln und Flügel.

Abstract

The most important transformation in the international economy over the last two decades has been the rise of the BRIC economies – those of Brazil, Russia, India and China. These countries have experienced massive economic growth, and play an increasingly critical role in global trade in goods. More recently, BRICs – especially China – have taken on yet another critical role as sources of loans to developing countries. While loans from wealthy democracies to developing countries declined from \$216 billion in the 1990s to \$128 billion in the 2000s, loans from BRIC governments increased from \$9 billion to \$85 billion. Cash-strapped governments often find loans from BRIC lenders attractive because they come with fewer “strings” attached. Yet what is puzzling is that despite the apparent benefits of such loans, only a third of all developing countries have jumped at the opportunity to abandon the United States and the IMF by borrowing from China instead. That is, most governments have not taken advantage of loan offers by BRICs, but continue to faithfully borrow from traditional creditors. Given the apparent availability of “easy money,” why do some developing countries choose BRIC loans over IMF loans while others do not?

My dissertation is the first to systematically explore the response by developing countries to loan offers by BRICs. I argue that the key determinant of loan choice is the relative power of Labor interests versus those of Finance and Industry. Because the loans offered by the World Bank and IMF have systematically different conditions than loan offers from BRICs, they create different relative winners and losers among Industry, Finance and Labor. Loans from traditional lenders tend to come with stringent conditions that favor fiscal prudence and price stability, largely benefiting Finance and Industry, whereas BRIC loans fund projects with few conditions of state spending, benefiting Labor through employment generation. By analyzing which coalition dominates politically, I can explain why some governments turn to BRICs while others turn to the IMF or private foreign

creditors.

I support my argument with both qualitative and quantitative evidence. Interviews with decision makers in Ecuador, Peru and Colombia provide empirical support on a micro level. I triangulate the insights from the field with a statistical analysis of loan data to test whether my argument holds for a larger set of cases.

The normative implications of my findings pertain to three issues: power, economic development and democracy. With respect to the first issue, loans to foreign countries are thought to provide creditor countries with a degree of power over recipient countries. Previously, this process was understood to be determined by creditors alone, such as the US and the USSR during the Cold War. However, my dissertation points to the power of recipient countries to affect the outcome of this confrontation. Thus, my work illuminates how globalization actually increases small states' room to maneuver in an increasingly globalized world. Second, the debate regarding economic development is currently dominated by two paradigms. On the one hand, there is the (neo-)liberal model promoted by western actors. Here, citizens are enabled to be productive members in markets governed by comparative advantages by improving the skills and abilities of individuals. On the other hand, the industrialization paradigm draws inspiration from the East Asian Tigers (e.g. South Korea and Taiwan). It therefore focuses on creating new comparative advantages by actively promoting industrialization. My dissertation spells out which countries follow which development path, and therefore provides insights into the prospects of lifting millions out of poverty. Third, there is democracy. Many have argued that Chinese loans might undermine democracy in recipient countries as the loans lack 'good governance' conditions. I provide a different view. My dissertation is a major step towards understanding the distributional consequences of different loans. If IMF loans benefit the capital owners who are already rich, but Labor – the numerically largest actor – benefits from BRIC loans, emerging creditors might contribute to a reduction in inequality, which has been shown to make democracy more likely.

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Chapter 1

BRICs and Cliques

1.1 Introduction

1.1.1 Different countries, different loans

On October 15, 2006, none of the candidates in the first round of the Ecuadorian presidential elections were able to obtain an absolute majority. In the second round on November 26th, voters were asked to decide between Álvaro Noboa of the right-wing party Partido Renovador Institucional de Accin Nacional, and Rafael Correa running for the social movement Alianza PAIS. Correa won the presidential election with 57% of the vote. After his election – but a full month before being sworn into office – Correa announced on December 15, 2006 that his administration would re-negotiate Ecuador’s external debt, stating that “La vida antes que la Deuda” – life should take priority over debt. Correa’s words were followed by deeds as Ecuador paid off all IMF loans at once and in full on April 20, 2007, thereby fulfilling one of his campaign promises.

A month later, in July 2007, Correa issued a decree instituting the “Comisión para la Auditoria Integral del Credito Publico” [Commission to Audit the Entirety of Public Debt], abbreviated as CAIC. Its task was to examine the legitimacy of different types of debt (multilateral, bilateral, private and domestic debt) that Ecuador had accumulated

over the years and determine whether these debts should be repaid. While these investigations were ongoing, interest payments came due on November 14, 2008 for the remaining government bonds held by private creditors. Correa declared that he would not pay the interest payments on these bonds until CIAC's findings were obtained. CAIC's final report was presented on November 20, in Quito, in front of a large crowd of Ecuadorians, along with a televised ceremony. The commission recommended suspending the debt repayment on many of the remaining bonds. Following the recommendation of the commission, the government suspended payments on the principal of the Global12-Bonds as well as the Global15- and Global30-Bonds, making Ecuador's default official.

On April 24, 2009, after it had become clear that Ecuador had no intention to repay this debt, creditors were willing to accept the conditions of a debt swap: The Global Bonds were exchanged for new bonds worth only 30% of the original face value. Two days after this announcement, Ecuadorians were again called to the ballots to vote in the first round of a presidential election. However, this time the result was unexpected as, for the first time since 1979, a second round of voting was unnecessary. Correa gained an absolute majority with 51.9 % of all votes in the first round.

Notably, Ecuador's behavior towards traditional western creditors differed markedly from its behavior towards emerging creditors – in particular Brazil, Russia, India and China, the so-called BRICs. Correa effectively stopped servicing existing debt from traditional western creditors, but continued to pay interest and principal on that debt. For instance, in January 2007 the installment due on loans to Brazil for the San Francisco hydropower project were paid on time. During this time, when Ecuador needed to take out new loans, credit offers by traditional creditors were explicitly rejected. Instead, the government obtained several loans from China, Brazil and Russia. For example, Ecuador announced on February 20, 2009 that it would borrow \$1.7 billion from China. This was only the first of several major loans: to date, Ecuador has obtained a total of \$5.4 billion in loans from China.

Puzzlingly, while Ecuador turned away from traditional western creditors towards BRIC loans, neighboring Colombia did the opposite. Instead of borrowing from the Chinese, Colombia continued to borrow from traditional creditors. This is surprising, because there were several opportunities for Colombians to borrow from the Chinese. After all, the Chinese Development Bank has maintained a permanent office in Bogota since 2007 (Guarin, 2011). Colombian public officials report that the loan proposals by the China Export-Import bank were rejected by the government (Chacón Peña, 2011 *a*). The economic advisor to the Chinese ambassador confirmed loan offers were made, but also that the Colombian government has been hesitant to accept these offers (Quan, 2011).

The Chinese have also offered to finance several public works projects. For example, in 2005 the Colombian government wanted to build an alternative to the Panama Canal, a so-called Canal Seco [Dry Canal]. The government inquired whether foreign creditors – the Chinese among them – would be interested in financing this project. The Chinese were initially thought of highly, but they were not selected for the project (Garcia, 2011; Leitteritz, 2011). In addition, Colombian officials confirmed that the Chinese offered a loan to the state-owned enterprise ColPetrol. Yet again, this loan offer was rejected (Rojas Hayes, 2011). Finally, Colombia rejected a Chinese loan offer for financing a hydropower project, the Acueducto Metropolitano de Bucaramanga. Instead it favored borrowing from a regional multilateral organization, the Andean Development Cooperation (CAF). However, as these negotiations fell through, Colombia still did not use Chinese money but rather borrowed from a private market actor, Bancolombia. In sum, the Colombian government had many opportunities to obtain loans from China. Instead, it chose to explicitly reject these loan offers and borrow from traditional lenders such as the IMF, western governments and the private capital market.

What explains this puzzle? Why did Ecuador reject traditional lenders and turn to BRICs? And why did Colombia, in contrast, reject Chinese loan offers and continue borrowing from traditional creditors?

1.1.2 The question of this study

The most important transformation in the international economy over the last two decades has been the rise of the BRIC economies of Brazil, Russia, India and China. These countries experienced massive economic growth, and play an increasingly critical role in global trade in goods. As evidenced by the example of Ecuador, BRICs – especially China – have taken on yet another critical role as sources of loans to developing countries. While loans from wealthy democracies to developing countries declined from \$216 billion in the 1990s to \$128 billion in the 2000s, loans from BRIC governments increased from \$9 billion to \$85 billion.

Cash-strapped governments often find loans from BRIC lenders attractive because they come with fewer “strings” attached. Yet it is puzzling that despite the apparent benefits of such loans, only a third of all developing countries have taken advantage of the opportunity to replace the United States and the IMF by borrowing from China instead. That is, most governments have not accepted loan offers by BRICs, but continue to faithfully borrow from traditional creditors. Given the apparent availability of “easy money,” why do some developing countries choose BRIC loans over IMF loans while others do not? Specifically, why did Ecuador turn away from traditional lenders and borrow from China, while Colombia rejected Chinese loan offers and continued to borrow from western creditors?

My dissertation is the first to unpack the puzzle of why some developing countries tend to accept loan offers from BRICs while others do not. I argue that the key determinant of loan choice is the relative power of Labor interests versus those of Finance and Industry. Because the loans offered by the World Bank and IMF have systematically different conditions than loan offers by BRICs, they create different relative winners and losers among Industry, Finance and Labor. Loans from traditional lenders tend to come with stringent conditions that favor fiscal prudence and price stability, largely benefiting Finance and Industry, whereas BRIC loans fund projects with few conditions of state spending, benefiting Labor through employment generation. Existing economic conditions, combined with the structural strength of Labor, shape which actors dominate politically. The resulting

coalitions account for whether developing countries pursue BRIC loans or traditional loans. In short, if Labor dominates the political arena, governments will borrow from BRICs to satisfy the demands of this societal group. For the same reason, the government will reject loan offers from the IMF, western governments, or private creditors. In contrast, in countries dominated by Finance or Industry, governments will avoid BRIC loans and borrow from traditional creditors instead.

1.2 The empirical puzzle

1.2.1 Actors and loan types

Sovereign loans are loans that the government of a country obtains in the name of its population from external creditors. Governments can borrow from a variety of sources. I distinguish between four types of creditors from which a government can choose – IFI, DAC, BRIC and private lenders. IFI loans are granted by International Financial Institutions such as the International Monetary Fund (IMF) or the World Bank. The disbursement of these loans is typically tied to certain ‘good governance’ conditions that aim at issues of transparency, anti-corruption and protection from mismanagement. More generally, these conditions intend to remove obstacles to an efficient market system in the recipient country, so as to improve the business environment for both domestic and foreign companies.

Secondly, a government can also borrow bilaterally from the governments of other countries. I distinguish between bilateral loans of western countries and bilateral loans from BRICs as the characteristics of their loans differ. Western countries are organized in the Development Assistance Committee (DAC). The member countries of this formal group, situated within the Organization for Economic Cooperation and Development (OECD), have agreed to harmonize their lending procedures in order to promote the principles of ‘good governance.’ I therefore call this group of western government the group of DAC creditors. DAC loans can be given by a variety of creditor institutions, such as a specific

aid agency like USAID or the US government directly.

In contrast to DAC creditors, the lending activities in the third loan type are not constrained by such self-imposed rules. BRIC loans feature non-traditional lending arrangements such as repayment in natural resources such as oil or copper. In addition, BRIC loans typically include the condition that funds be spent on materials or services obtained from the lending country. The provider of such services is usually a state-owned enterprise. For example, the governmentally owned Chinese Development Bank (CDB) lent the Ecuadorian government \$2.8 billion for the construction of the Coca Codo Sinclair Hydroelectric Power Dam. Part of the agreement was that Ecuador would use a Chinese firm to construct this dam. Just like DAC countries, BRICs have specific institutions granting these types of loans. For example, the Chinese Development Bank (CDB) and the Export-Import (EXIM) Bank make these types of arrangements in the name of the Chinese government.

Lastly, governments of developing countries can also obtain resources from private creditors through either bonds or syndicated loans. The former are securities issued by a government that promise the creditor will pay interest for the duration of the bond and repay the principal once the maturity date has arrived. Typically, bond holders are a diverse set of both domestic and foreign institutions and private individual investors. In contrast, syndicated loans are jointly extended by a group of foreign banks.

The loans can take a variety of forms. For example, IMF loans are released only after the recipient government satisfies conditions, such as cutting expenditure or changing regulations. However, once the resources are transferred, the government can employ the resources in whatever way it wants, such as balancing the budget or financing particular government programs in education or social welfare.¹ In contrast, BRIC loans are often

¹ The difference between loans and aid is blurry at times. For instance, the Development Assistance Committee (DAC) classifies loans that are concessional (i.e. that have a low interest rate and long financing terms) as aid, while loans with less favorable terms are not counted. Since the criteria for what is classified as aid and what is not differ across lenders, my approach is to count any monetary transfers with the condition of repayment and a positive interest rate as a loan. I therefore exclude grants as they represent transfers without the requirement for repayment.

earmarked for specific projects such as bridges, roads or hospitals. These projects are different from foreign direct investments (FDI) that are designed, financed, and implemented by private foreign companies. In these cases, the government does not design or finance the investment, but foreign companies nevertheless might need to obtain concessions from the government to gain the right for a coal mine or an oil drilling project. In contrast, I am concerned with the loans that finance projects designed and funded by the government, while only the implementation of the project might be outsourced.

Having defined the subject of my study – sovereign loans – let me clarify what my study will not cover. I will not analyze the determinants of humanitarian aid and assistance, such as sending emergency food aid or doctors to developing countries. Also, foreign direct investment (FDI) is not part of this study. While investors entering a developing country might need to obtain a concession from the government for their project, the funding and implementation of a FDI project is entirely in the hands of the foreign investor.

1.2.2 Volume and trends of BRIC lending

Over the past 40 years, BRIC countries have made loan commitments amounting to about \$101 billion. However, the vast majority of this amount was granted after the year 2000. Figure 1.1 illustrates that BRICs are not ‘new’ lenders in the narrow sense. Brazil, India, Russia and China have made loans since the 1970s, even though in very small loan amounts. However, around 2000, things changed as the four countries began to massively expand their loan volumes.

More specifically, of the 1,154 lender-borrower dyads in which BRICs lend to developing countries, roughly half of the yearly commitments – 532 – were smaller than \$10 million. In fact, prior to 2000, the lending by BRICs were almost comically small. For example, Table 1.1 shows that the loan commitment of China to the Maldives in 1995 totaled \$1,560.

However, since then, BRIC lending has changed dramatically. As evidenced by Figure 1.1, the lending volume of China, Brazil, India and Russia has increased significantly since

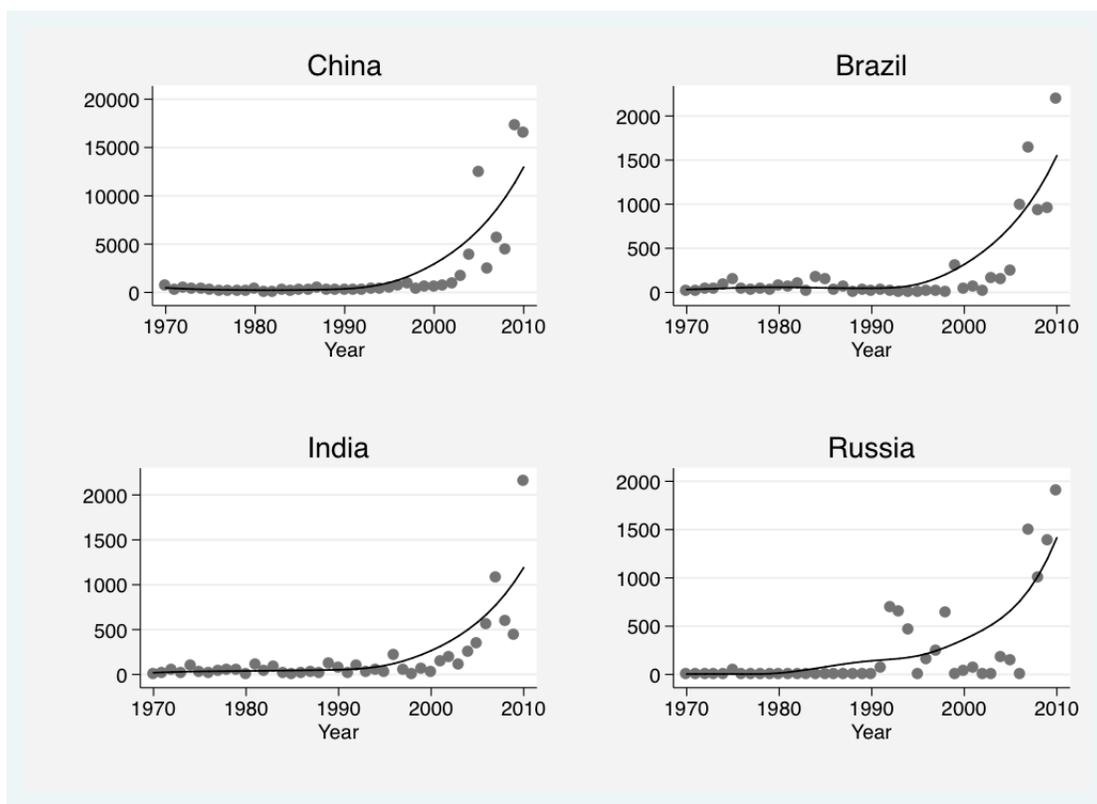


Figure 1.1: Trend in lending volume by China, Brazil, Russia and India

2000. For example, an interviewee revealed to me that when he was Peruvian Vice-Minister of the Economy he was approached by representatives of the Chinese Development Bank that inquired whether there were any projects that they might help finance. The minister then gave the Chinese delegation a list of potential loans they might be interested in, of which the largest project had a volume of \$2 million. The change in lending practices by the Chinese is well-captured by their response: “Don’t you have anything larger?” (Morón Pastor, 2011). This anecdote can be complemented by aggregate data. For example, Table 1.2 displays the BRIC annual lending commitments in excess of \$1 billion, each of which has been granted after 2004. For example, Angola obtained a loan of \$9.8 billion in 2005. For the purposes of this study, I will therefore only focus on BRIC loans of respectable size

Year	Recipient	Creditor	Commitment
1987	Zambia	Russia	\$1,100
1995	Maldives	China	\$1,560
1978	Ethiopia	China	\$5,400
1987	Seychelles	Russia	\$9,280
1977	Ethiopia	China	\$13,500
1993	Bangladesh	India	\$14,160
1996	Armenia	Russia	\$17,820
2002	São Tomé and Príncipe	China	\$21,630
1997	Ethiopia	China	\$21,710
1999	Lesotho	China	\$22,350

Table 1.1: The 10 smallest lending commitments in a given year BRICs, 1970-2010.

Year	Recipient	Creditor	Commitment
2010	Bhutan	India	\$1.0 bn
2010	Ethiopia	China	\$1.1 bn
2007	Vietnam	China	\$1.2 bn
2009	Sri Lanka	China	\$1.2 bn
2010	Belarus	Russia	\$1.4 bn
2007	Belarus	Russia	\$1.5 bn
2009	Pakistan	China	\$1.6 bn
2010	Pakistan	China	\$1.8 bn
2004	Angola	China	\$2.0 bn
2009	Angola	China	\$2.6 bn
2010	Ecuador	China	\$2.7 bn
2010	Angola	China	\$3.5 bn
2009	Brazil	China	\$7.0 bn
2005	Angola	China	\$9.8 bn

Table 1.2: All BRIC lending commitments in a given year larger than \$1bn, 1970-2010.

that are representative for the rise of BRIC lending.

The regional distribution of these loans mirrors that of DAC countries (see Figure 1.2). The vast majority of this amount was granted to governments of sub-saharan African countries, followed by recipients in Latin America. Countries in the Middle East and North Africa received the fewest loan commitments. Notably, the lending destinations of each individual BRIC differ somewhat. Considering BRIC loans given over the past ten

years, China and India have lent primarily to African countries, while Brazilian loans are concentrated in South America. In contrast, Russian lending does not seem to follow any clear pattern (see Figures 1.3 and 1.4 respectively).

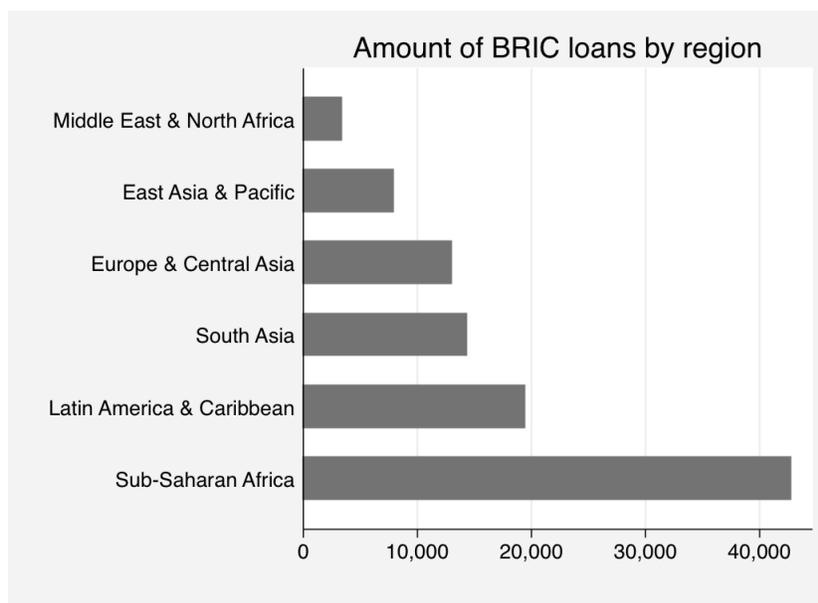


Figure 1.2: Comparison of BRIC lending volume by region

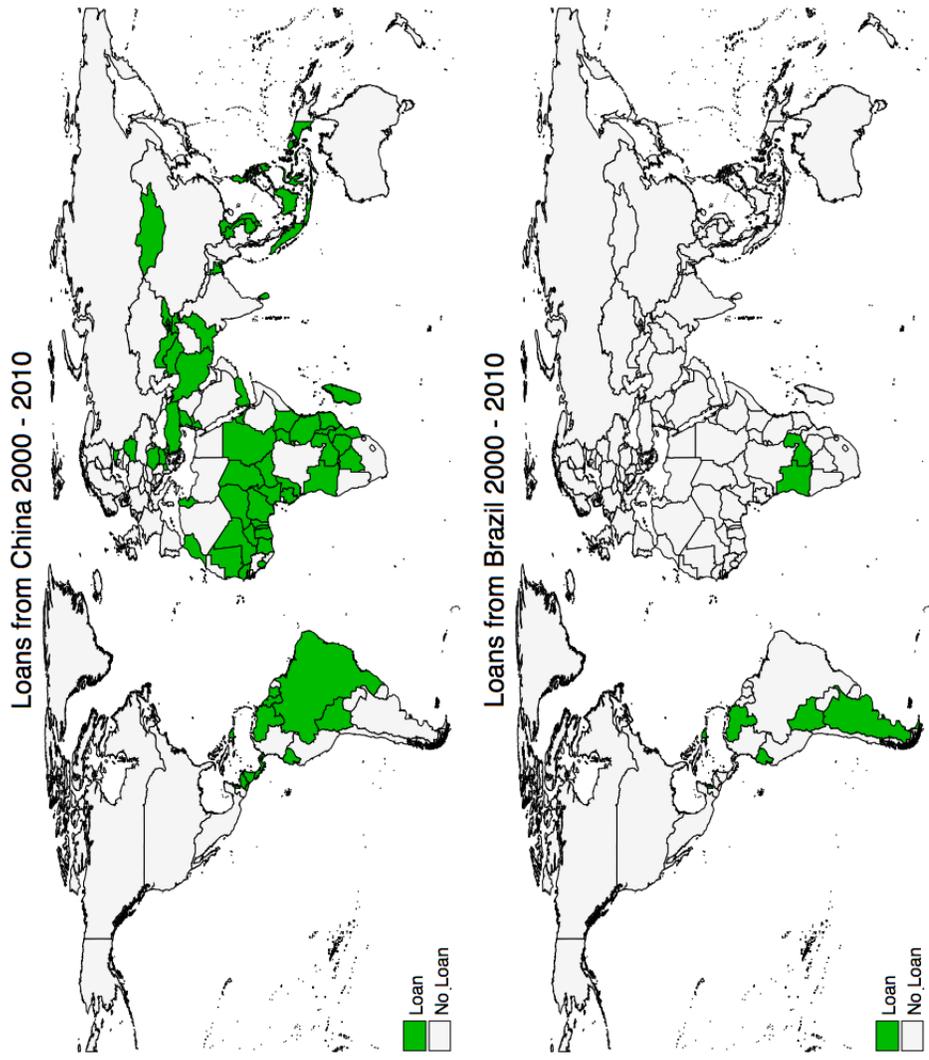


Figure 1.3: Destination of Chinese and Brazilian loans 2000-2010

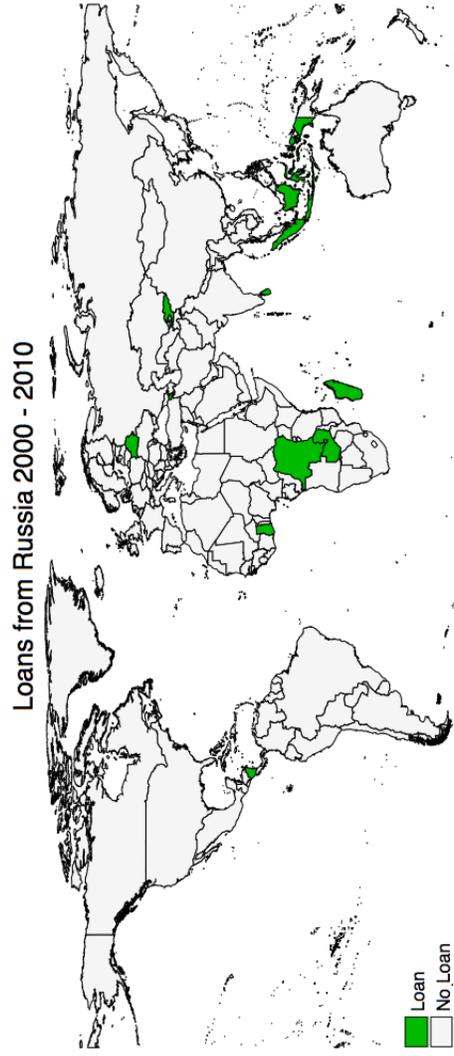
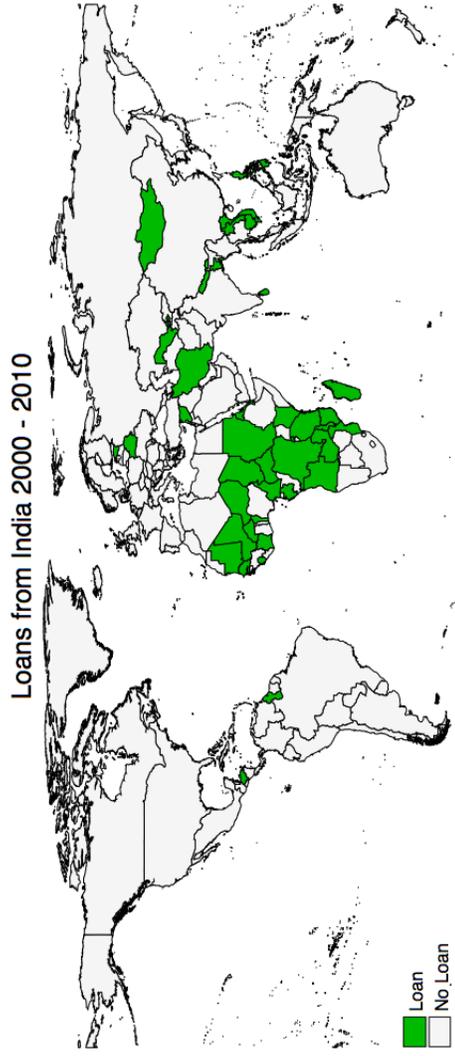


Figure 1.4: Destination of Indian and Russian loans 2000-2010

1.2.3 The puzzle

The data presented above provide powerful testimony to the fact that BRIC loans are on the rise. One sign of their dramatic transformation from nobodies into major players in the international financial markets is their expansion of loans to developing countries **at the expense** of traditional lenders. While lending commitments of western governments to developing countries declined from \$216 billion in the 1990s to \$128 billion by 2010, the commitments by BRIC lenders increased from only \$9 billion to \$85 billion. Figure 1.5 illustrates this trend: with the rise of BRIC lending to developing countries, western governments lost ‘market share.’ BRIC loan commitments surpassed DAC commitments for the first time in 2009, when emerging creditors lent a total of \$20 billion to developing countries, while DAC loans only amounted to \$17 billion. This reversal continued in 2010 with BRICs committing a total of \$23 billion, while DACs lent only \$19 billion. At the same time, the demand for IMF loans decreased significantly.

Chinese loans come with ‘fewer strings attached,’ which explains their considerable attraction for cash-strapped governments. Yet despite their apparent benefits – and although a shortage of liquid assets characterizes nearly all developing economies – only a third of all developing countries have taken the opportunity to shift their composition of new borrowing in favor of Chinese loans. In contrast, other governments explicitly rejected loan offers by BRICs, and continue to faithfully borrow from traditional creditors. Why do some developing countries choose BRIC loans over IMF loans? And why do some countries refuse BRIC loan offers?

Contrasts in borrowing patterns by governments in Ecuador, Peru and Colombia illustrate this point. These neighboring countries are located in the same geographical region, all have ports at the Pacific Ocean, and are similarly proximate to China. Furthermore, Ecuador, Peru and Colombia share the same historical and cultural heritage as well as a common language. All three countries are presidential democracies with a similar institutional set-up. However, the domestic coalitional dynamics between societal interest groups

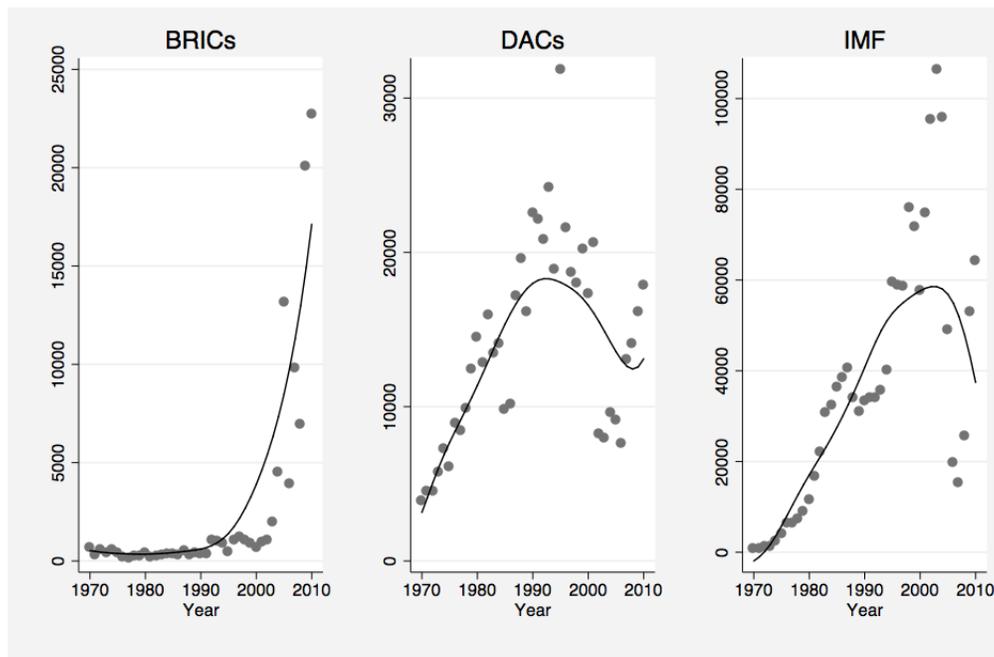


Figure 1.5: Comparison of trends in lending volume across BRICs, DACs and the IMF.

differ. I will show that this explains their divergent borrowing patterns from 2005 to 2011.

Over the years, Ecuador borrowed a total of \$2.7 billion in loans from China. This consisted of one loan for the Coco Coda Sinclair project, valued at \$1.7 billion as well as a \$1 billion untied credit. In addition, in 2011, Ecuador obtained a \$0.6 billion loan for the Sopladora Electrical project as well as another \$2 billion untied loan. Interestingly, the latter is divided into two tranches, of which \$1.4 billion was denominated in US dollars, while the remaining \$0.6 billion was denominated in renminbi (Minoli, 2011). At the same time, Ecuador reduced its exposure to western creditors such as the IMF and private creditors. In contrast to Ecuador, Colombia has explicitly rejected loan offers by China and continues to borrow from traditional creditors. Consequently, the rise of BRIC lenders has not had an impact on Colombia's debt portfolio which has remained unchanged. Peru's experience differs from that of either Colombia or Ecuador as it exhibits variation over time. In the

1990s, Peru obtained Chinese loans almost yearly, albeit in comparatively small amounts. However, prior to the 1990s and since the year 2000, Peru has not borrowed a single cent from China. This pattern again accentuates the question of why some governments borrow from China while others do not.

1.3 Existing explanations

1.3.1 Easy answers, inadequate answers

Why do the governments of some developing countries borrow from BRICs, while others do not? Confronted with this puzzle, researchers have offered several explanations. For example, some scholars suggest that ideology might explain the distribution of BRIC loans (Clapham, 2008; Yeh, 2008; Adebajo, 2008; Sachikonye, 2008). The argument is that a quasi-communist country such as China would be more willing to lend to countries that share a similarly leftist political view of the world. However, the facts do not square with this hypothesis. The governments of the 50 developing countries that have borrowed large amounts from China over the past decade have been both leftist and conservative.

Other scholars have suggested that the Chinese are primarily interested in natural resources (Zhao, 2007; Yagtes, 2007; de Oliveira, 2008; Lee and Shalmon, 2008; Rotberg, 2008; Brautigam, 2009). It should, therefore, be expected that Chinese capital flows to countries that have natural resources. Examples include iron ore for the Chinese steel industry, or coal and oil for Chinese energy needs. However, this hypothesis does not explain why China would be engaged in financial relations with resource-poor countries such as Ethiopia. Further, Chinese loans are financing projects such as hydroelectric dams in Ecuador. As these projects produce output that cannot simply be shipped off to China, this hypothesis cannot explain the lending patterns either. Also, both the ideology hypothesis and the natural resource hypothesis are supply-side arguments. The driving force of lending is assumed in these hypotheses to be the creditors and their interests in developing

countries. However, during my fieldwork in Ecuador, Peru and Colombia I learned that the Chinese have representatives in all three countries and have made loan offers to all of them. Yet, not all of these countries accepted such offers. It therefore appears that the determinants for which countries obtain capital from China are not driven by the Chinese supply, but rather by the characteristics of the (potential) recipient country.

In examining reasons a country would accept loans from BRIC countries while others do not, a third suggestion points towards the country's history with the IMF. Some scholars argue that the IMF has in the past attached macroeconomic conditions to their loans that have proven to be harmful to developing countries (Pastor, 1987; Garuda, 2000; Przeworski and Vreeland, 2000; Vreeland, 2002; Nooruddin and Simmons, 2006). For example, so-called Structural Adjustment Programs (SAPs) require recipient countries to implement austerity measures in order to balance their budget. It is suggested that recipient countries despise these conditions and are therefore looking for alternatives to the IMF – such as BRIC loans. However, this argument should apply to any developing country that previously received a loan from the IMF. However, not all clients of the IMF are turning away from this multilateral institution in order to instead borrow from BRICs. In addition, this hypothesis ignores the fact that Chinese loans also come with conditions. For instance, Chinese project loans require the recipients to use the resources to purchase materials and services from China.

1.3.2 Why previous explanations have fallen short

When searching for an explanation to a particular puzzle, it is insufficient to simply dismiss existing arguments as soon as contradicting evidence is presented. Instead, I will analyze the underlying reasons why existing work is unable to provide an acceptable answer to the puzzle. I argue that existing work undertheorizes the nature of borrowing decisions and ignores the domestic political dynamics in a recipient country.

The dependent variable

I argue that the outcome to be explained is misspecified. Existing literature focuses on why countries borrow from a *single* creditor. This is the case for the existing literature on the determinants of borrowing from the IMF (Copelovitch, 2010*b*; Vreeland, 2003*b*; Thacker, 1999), from western bilateral creditors and from private creditors (Tomz, 2007). Similarly, the emerging literature on BRIC loans to developing countries focuses only

I argue that analysis of a single creditor in isolation from other creditors is unable to produce convincing explanations of borrowing patterns. This is because an isolated analysis cannot capture the borrower's decision-making process as it chooses *between* the different sources of credit. Thus, the borrower's decision-making process should be at the center of the analysis for two reasons.

First, analyzing the determinants of borrowing from a single source instead of a set of creditors is unable to capture the strategic nature of the borrower's choice. Just as with private individuals, sovereign borrowers cannot obtain an unlimited amount of loans. This constraint of a maximum debt ceiling has important implications. It introduces an interdependency, as a borrower's decision for one creditor is also a decision against another. The choice between creditors, under the constraint of a maximum debt ceiling, involves opportunity costs for the borrower. Any analysis of borrowing patterns must therefore take into consideration the strategic element that arises from the presence of opportunity costs. It is therefore essential that explanations of borrowing decisions do not focus on the determinants of borrowing from a single creditor. Instead, this interdependency requires successful theories to explain the choice between different creditors. While similar approaches have a long tradition in the field of firm financing (Modigliani and Miller, 1958), the same comprehensive approach has not been applied to sovereign borrowing.

Second, loan agreements are the result of negotiations between the debtor and creditor (Nooruddin and Simmons, 2006). A central determinant of power in bargaining situations is the presence of alternative options that an actor has available. The fewer options an actor

has, the more desperate she is to reach an agreement regardless of the costs. Conversely, if an actor does have alternatives besides reaching an agreement with the current negotiation partner, her negotiation position is more powerful. Loan negotiations between a developing country and a single creditor are governed by the same principles. Analyzing the relations between developing countries and only single creditors in isolation, while ignoring that countries have alternative borrowing options, will result in biased findings as the negotiation power of countries will be underestimated. To understand why countries borrow from particular creditors, we need to examine the full range of options. Thus, the outcome to be analyzed should be the decision-making process by which a developing country chooses between the borrowing options available.

The independent variable

In addition to misspecifying the outcome to be explained, existing explanations for countries' borrowing decisions have ignored the variation of domestic political factors within recipient countries. Scholars have argued a developing country may want to obtain IMF loans because of the conditions attached to such a loan. The conditions of IMF loans typically involve a series of fiscal and macroeconomic adjustments that aim to make the domestic business environment more attractive, particularly to foreign investors. An IMF program is therefore a "seal of approval" and thus a signal to potential foreign investors (Stone, 2002) and creditors (Aggarwal, 1996). In addition, conditions of an IMF loan provide the recipient government with leverage to implement unpopular economic reforms – such as devaluations or austerity measures – against domestic resistance (Remmer, 1986; Edwards and Santaella, 1993; Vreeland, 2003*b*). As Putnam (1988, p.457) noted, "International negotiations sometimes enable government leaders to do what they privately wish to do, but are powerless to do domestically. [...] This pattern characterizes many stabilization programs that are (misleadingly) said to be 'imposed' by the IMF."

However, these approaches cannot explain why governments' borrowing strategies differ.

If IMF loans are a public good, why do some governments reject such loans? I argue that the inability to answer this question is the treatment of sovereign borrowers as a single unified actor. While researchers acknowledge divergent domestic interests, their analyses do not factor those interests as influences. Rather, the central government is assumed to be the only relevant actor on the part of the borrowers. Divergent domestic preferences are treated in these situations as a nuisance that must be dealt with by the benevolent central government, and using the IMF as an external force to silence domestic interest groups is one way of doing so. Thus, in these hypotheses, the causal arrow points from the central government to the societal interests, but not the other way around.

I argue that this assumption is misplaced and the causal arrow should point from the societal interests to the central government. In this case, domestic interests would determine how a government acts in loan negotiations. This approach has gained prominence with respect to trade policy (Rogowski, 1989; Grossman and Helpman, 1994; Scheve and Slaughter, 2001; Hiscox, 2002; Baker, 2003) but it has not been applied to sovereign loans. My study is the first to systematically explore the politics of sovereign borrowing.

Requirements for a satisfactory explanation

In sum, a satisfactory explanation of countries' borrowing decisions needs to take two considerations into account. First, because the interdependency between the decision to borrow from one creditor versus another exists, it is insufficient to examine only the determinants of borrowing from a single creditor. A satisfactory analysis must explain the composition of new borrowing that results from the series of decisions between competing loan offers by various creditors in a given year. Second, such an analysis must incorporate the preferences of the domestic actors to which the government responds. I argue that the political dynamics of competing domestic interest groups explains the governments' decisions regarding their choices of creditors.

1.4 My argument

This study is the first to systematically explore the response by developing countries to loan offers by BRICs. While the analytics of this argument are established in Chapter 2, a preview shall be presented here. In short, my explanation is based on conflict between economic groups over the following borrowing options: whether to borrow from western governments, from the IMF or World Bank, from private foreign banks, or from emerging lenders. Because the conditions attached to each type of loan differ, each tends to create a different set of relative winners and losers. By analyzing which coalition dominates politically, I can explain why some governments turn to BRICs, while others turn to the IMF or private foreign creditors.

To derive which type of domestic political coalitions will result in BRIC loans, I begin with analyzing the individual preferences of three domestic interest groups – Finance, Industry, and Labor – among the borrowing options. Finance is interested in policies that promote a stable business environment and prevent financial crisis. Considering the characteristics of the loan options available to a government, it is likely that Finance would be in favor of IMF loans, seeing that conditions attached to these loans are designed to prevent banking crises and ensure an efficient market system. In contrast to Finance, Labor is interested in higher wages and employment opportunities. Based on existing scholarship, IMF loans are unlikely to serve these interests. In contrast, BRIC loans are typically tied to specific investment projects and therefore employment opportunities. I continue this exercise of comparing the interest of the three actors of Finance, Industry and Labor to the characteristics of the four borrowing options. This allows me to derive a preference profile for the actors across the different types of creditors (see Table 1.3).

However, whose preferences will be implemented by the government? I assume that when making the borrowing decision a government will be motivated by maintaining incumbency. If want to politicians want to remain in office, it is in their interest to maximize

	Multilateral creditors	DAC creditors	BRIC creditors	Private creditors
Finance	+	+	-	+
Industry	o	-	+	+
Labor	-	+	+	-

Table 1.3: Summary of expected distributional consequences by actor.

votes while minimizing the expenses to secure those votes. In order to maximize the number of votes politicians can get, they have the incentive to choose policies that satisfy the demands of multiple interest groups simultaneously. I suggest that politicians therefore observe the overall economic and political environment to determine whether or not the interests of two actors are congruent. For example, if employment in Industry is high, Labor can be expected to have similar interests to Industry due to its dependence on that sector. In contrast, under conditions of high inflation, Labor's interests are likely to be congruent with those of Finance. While inflation devalues the capital owned by Finance, it also lowers the real wages of Labor. In sum, depending on the overall state of the economy, the interests of Labor are either congruent with those of Finance or those of Industry. I suggest that politicians perform this exercise for both Finance and Industry in order to determine under which conditions the respective groups' interests are congruent. By combining the information on the groups that share interests, politicians arrive at three distinct informal coalitions whose demands can be met simultaneously with a single policy:

- Corporatist coalition: Industry + Labor vs. Finance
- Capital coalition: Finance + Industry vs. Labor
- Consumer coalition: Finance + Labor vs. Industry

However, note that these are not formal coalitions. There are no written agreements between, say, Labor and Finance that they will lobby the government to borrow from the IMF as opposed to the emerging lenders. Rather, I assume that the causal mechanism of preference aggregation begins with the office-motivated politicians in government.

	IFI creditors	DAC creditors	BRIC creditors	Private creditors
Capital coalition	+	o	o	++
Corporatist coalition	-	o	++	o
Consumer coalition	o	++	o	o

Table 1.4: Summary of expected distributional consequences by coalition.

To determine which policies would be optimal for politicians to pursue given a particular type of coalition, I aggregate the preferences of each actor across loan options (see Table 1.3) to arrive at the loans demanded by the possible actor-coalitions. If both actors individually prefer a particular creditor, their joint preference will reflect this agreement and exhibit a strong preference for this creditor. If, however, the two coalition partners have divergent preferences with respect to a particular borrowing option, the aggregate joint preference will be weak with respect to this creditor. Table 2.3 presents the joint preferences that result from this process.

After deriving the individual level preferences, the process of coalition formation, and the joint preference profile, I have identified the conditions under which governments have the incentive to choose BRIC loans over loans from traditional lenders. In short, I expect that BRIC loans are signed if a country is dominated by a Corporatist coalition (between Labor and Industry). In contrast, if a country is characterized by a Capital coalition (of Finance and Industry), its government will borrow from either the private market or the IMF. Lastly, DAC loans from western governments are obtained if a country is dominated by a Consumer coalition (between Finance and Labor).

1.5 Empirical strategy

A theory combining preferences and coalition formation is best tested using an empirical approach that combines the strengths of both qualitative and quantitative methods.

For this reason, I undertook several months of fieldwork to speak with key decision makers. However, most existing fieldwork, with respect to issues of sovereign debt, focuses

on interviewing IMF officials or other creditor representatives. In contrast, I interviewed domestic elites in three debtor countries: Peru, Ecuador, and Colombia. The case selection was guided by theoretical considerations derived from my conceptual framework. While they share characteristics such as political system, natural resource endowment, and distance from China, these countries differ markedly in their coalitional dynamics. By conducting more than 100 elite interviews, I found that it is because of these political differences that only one country – Ecuador – has accepted loan offers from the Chinese.

I interviewed domestic representatives of the public sector (Prime Ministers, Finance Ministers, Senators, and representatives from Public Debt departments) to verify whether governmental decision-makers are taking domestic interest groups into account when deciding between creditors. I subsequently interviewed a broad range of actors in the domestic private sector (domestic banks and businesses, business associations). Through these conversations, I substantiated the theoretical expectation regarding which type of actor – Finance, Industry or Labor – hopes to benefit from which type of loan. Finally, I spoke with international actors such as officials of multilateral institutions and western development agencies. I was also able to interview Chinese officials, both from the public sector (Chinese Development Bank, Chinese embassies) as well as the private sector (Chinese banks, Chinese mining companies). The interviews with these actors confirmed that domestic considerations of recipient countries are an overlooked driver of lending patterns.

I complement the qualitative evidence with statistical analysis to test whether my argument applies to a larger set of countries than those where I undertook fieldwork. A quantitative analysis required two steps. First, I needed a measure that classified countries by the type of coalition present. While my fieldwork allowed me to identify which coalitions were present in Ecuador, Peru and Colombia, obtaining this information for all developing countries presented a challenge for two reasons. On the one hand, the outcome (i.e. choice of borrower) cannot be aligned along a one-dimensional left-right scale as would be the case with trade liberalization. On the other hand, there are no formal agreements between the

Finance, Industry and Labor to lobby the government with respect to a particular creditor. However, my conversations with politicians clearly indicated that they understood whose interests were aligned.

In the fact of this conceptual challenge, recall that I suggested above the central goal of each politician is to win or maintain office. Such office-seeking politicians hence have the incentive to cater to multiple constituencies simultaneously in order to maximize the prospect of maintaining incumbency. In such a situation it is advantageous to politicians if their policies can satisfy the preferences of multiple interest groups simultaneously. I argue that politicians carefully observe the structural conditions of the domestic economy to infer which actors are likely to have similar interests. Once they have analyzed which two of the three domestic actors have congruent interests, politicians have the incentive to implement policies – i.e. borrowing from the jointly preferred creditor – that satisfy the preferences of both actors at once. I modeled this decision-making process using a Latent Class Analysis. With this analysis I estimated whether each actor’s interests are more congruent with one or the other remaining actor. Aggregating this information allowed me to create a categorical measure capturing the type of coalition that characterizes a particular country.

In the second step, I used the newly-created categorical variable of the coalition type to predict the type of loan that the government is likely to obtain. For this purpose, I present a new dyadic-panel dataset on government borrowing for 129 countries. It uses a novel approach to obtain data on BRIC lending, which has so far not been available to researchers, as China, in particular, treats its lending activities as state secrets. In short, I did not follow the existing attempts of estimating the capital outflows from emerging lenders (see Brautigam, 2009). Instead, I worked with the World Bank to obtain their internal data based on information provided by developing countries on the sources of their capital *inflows*. With the dataset assembled using this approach I advance the current literature by providing systematic information on loan volume and lending conditions disaggregated

by recipient country.

To analyze the data I applied a novel estimator, a Differentiated Product Model. This model represents a major contribution to the current literature on sovereign debt. By implementing a Differentiated Product Model I go beyond what is possible with linear panel data methods or multinomial logit models. The latter lack the ability to estimate the demand for the four creditors simultaneously and instead require four separate regressions. In contrast to multinomial logit models, my empirical approach makes full use of all available data on borrowing patterns across countries and makes more appropriate assumptions about the data generating process. In addition, the Differentiated Product Model explicitly incorporates the ‘room to borrow’ that a country has available. Unlike other estimators, my model can therefore elegantly account for interdependency among creditors. As derived from my theory, a maximum amount of debt implies that a country’s decision *for* one creditor is simultaneously a decision *against* another.

Most importantly, the estimator allows for the calculation of the degree to which countries utilize particular creditors. In other words, it provides a consistent and efficient way to predict the *composition* of the total amount of loans obtained per year conditional on country characteristics. In contrast, existing scholarship on sovereign borrowing has only focused on explaining the choice for or against a single creditor while disregarding simultaneous borrowing from other sources. The estimation method proposed here thus represents a significant methodological contribution to the study of sovereign debt as it focuses on the composition of the loan portfolio acquired.

The empirical analysis provides strong support for the argument that social coalitions explain government’s borrowing decisions. For example, figure 1.6 displays the predicted share of loans obtained by the four creditors across the three coalitions. Countries characterized by a Corporatist coalition acquire 44% of the total loan amount obtained in a year from BRICs. In contrast, government agencies in countries with either Capital coalitions or Consumer coalitions utilize BRIC creditors to a much lesser extent, borrowing only 11% or

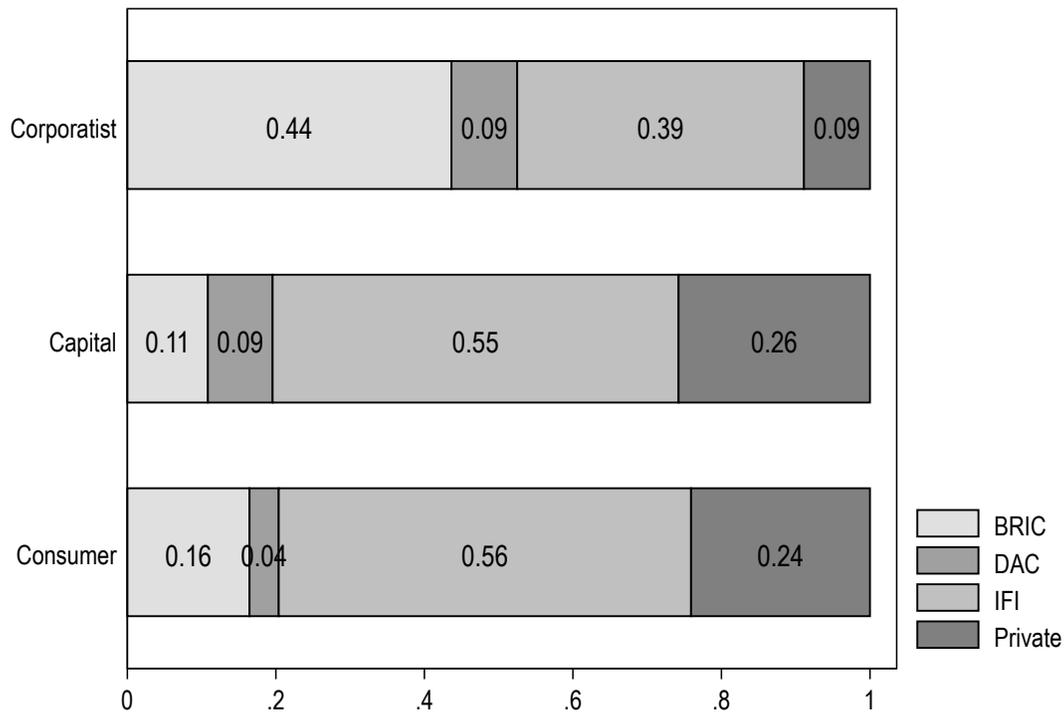


Figure 1.6: Predicted loan shares by coalition based on Differentiated Product Model.

16% on average but rely more heavily on IFIs and private creditors. Instead, these governments obtain more than half of their annual borrowing amount from IFIs (55% and 56%, respectively). While Corporatist coalitions are predicted to still obtain a sizable amount from IFIs, with 39% of the overall borrowing amount its share is about 30% smaller than that of the other coalitions. Lastly, Corporatist coalitions utilize private creditors to a minimal degree as only 9

While the comparison of the absolute shares of loans obtained from the four creditors across coalitions is indicative, the comparison of each type of coalition to a hypothetical ‘average’ country further illuminates the stark variation of borrowing behavior. As shown in Figure 1.7, Corporatist coalitions obtain a much larger share of the total volume of

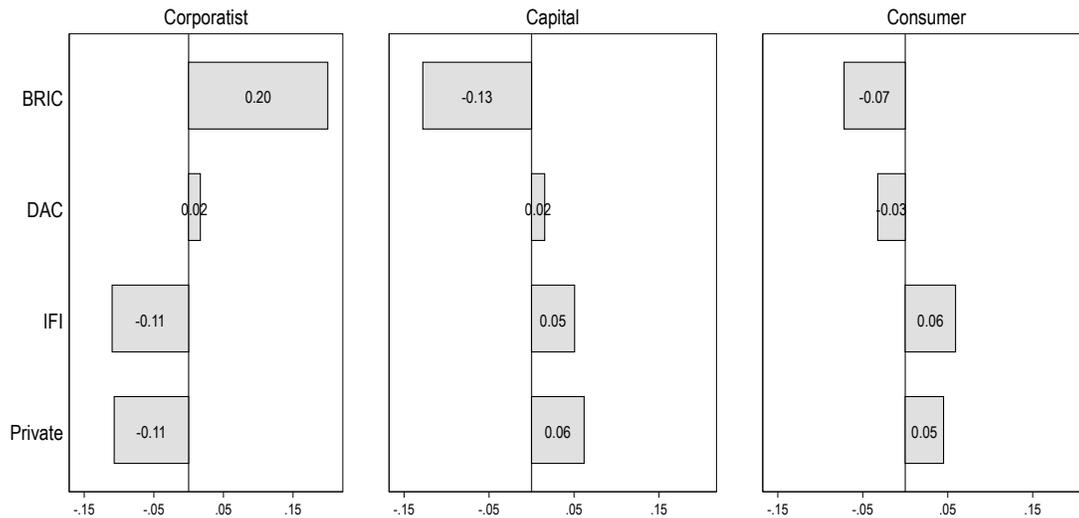


Figure 1.7: The difference in predicted loan share for each coalition in comparison to loan share obtained by average country.

loans acquired annually from BRICs, while Capital and Consumer coalitions underutilize this creditor. The differences across coalitions are remarkable. In contrast, there do not appear to be significant differences in the degree to which the three coalitions utilize DAC creditors. While Corporatist coalitions rely heavily on BRIC creditors, the opposite is true with respect to both IFIs and private creditors. In comparison to an average country, the predicted loan share of IFIs and private creditors is about 11% below average, while both Capital and Corporatist coalitions utilize these creditors to a higher degree than an average country.

In sum, both the qualitative evidence from my fieldwork and the quantitative analysis using a new dataset and an innovative estimation procedure confirm that governments in countries dominated by Corporatist coalitions are more likely to borrow from BRICs than traditional lenders.

1.6 Significance

1.6.1 Academic contribution

My research expands the boundaries of the literature on sovereign debt, which currently only explains whether or not governments borrow from a single type of lender. Thus, we know when developing countries borrow from the IMF (Copelovitch, 2010*b*; Vreeland, 2007) or the private market (Tomz, 2007). However, given the constraint that countries cannot borrow an unlimited amount, the decision to borrow from one creditor is also a decision to not borrow from another. My theory therefore provides a (Rogowski, 1989)-style unifying framework that explains how developing countries choose **between** several borrowing options. By illuminating the domestic political dynamics my research provides insights into why the sovereignty costs of governments vary across countries. Similarly, past work has been unable to explain credit rationing with economic variables only. Incorporating the domestic politics in recipient countries helps to explain why specific creditors want to offer credit to governments that have the incentive to avoid their type of loans.

My argument has broader implications in addition to the immediate explanatory value of its theoretical framework. First, my theory reconciles two contradictory findings. On the one hand, IMF programs have repeatedly been cited as the cause for popular protests. For example, Vreeland (2003*b*) describes instances where political leaders stand firm despite large public protests against the intention to sign an IMF agreement. Yet, scholars find that political leaders are not punished for signing IMF agreements. In particular, Sidell (1988) and Killick (1995) argue that IMF programs helped existing governments to maintain office. My theoretical framework reconciles these observations. While the minority actor – say Labor – may be in the streets protesting, I provide an explanation for why a government catering to a Capital coalition has the incentive to implement the preferred policy of Finance and Industry over Labor.

Second, scholars have been puzzled by the empirical fact that a country which has

received IMF loans in the past is more likely to receive an IMF loan again than a country that has never had dealings with the IMF. This so-called recidivism cannot be explained by economic factors alone as the differences in probabilities persist even when controlling for economic measures. Political scientists have therefore suggested that the domestic audience costs of obtaining IMF loans with their macroeconomic conditions differ systematically across these two sets of countries. In particular, participating in IMF programs incurs so-called ‘sovereignty costs’ as the public is expected to accuse the government of ‘selling out’ to the international institution. However, sovereignty costs decrease over time if the current government can point to previous leaders that have turned to the IMF in the past. With lower sovereignty costs, the likelihood of turning to the IMF again and again is higher than in countries that still would incur high sovereignty costs if they were to enter an IMF agreement for the first time (Vreeland, 2003*a*).

While this hypothesis can explain the dynamics of a country *after it has signed its first IMF agreement*, it does not explain why it would ever sign an agreement in the first place. After all, initially, both sets of countries were identical as neither had received an IMF loan. In contrast, my theoretical framework can explain the heterogeneity in sovereignty costs across countries without reference to some exogenous shock while also explaining recidivism. The focus on the political dynamics of domestic interest groups can therefore explain what type of countries are more likely to enter into an agreement with the IMF in the first place, *as well as* why they are more likely to return to the IMF over and over again.

1.6.2 Political significance

Why should we care who borrows from BRICs? The normative implications of my findings pertain to three issues: power, economic development and democracy.

With respect to the first issue, loans to foreign countries are thought to provide creditor countries with a degree of power over recipient countries (Waltz, 1979). Previously, this

process was understood to be determined by creditors alone, such as the US and, during the Cold War, the USSR. However, my research points to the power of recipient countries to affect the outcome of this confrontation. Thus, if the power of creditors depends on the decisions made by recipients – and not only on the decisions by the creditors – my work illuminates how globalization actually increases the room for small states to maneuver in an increasingly globalized world.

Second, there are currently two dominant paradigms regarding which development path countries should follow to arrive at economic development. On the one hand, there is the (neo-)liberal model promoted by western actors. Here, citizens are enabled to be productive members in markets governed by comparative advantages by improving the skills and abilities of individuals. On the other hand, the industrialization paradigm draws inspiration from the East Asian Tigers. It therefore focuses on creating new comparative advantages by actively promoting industrialization. Clearly, IMF and DAC loans advance the liberal paradigm by emphasizing education and health, while BRIC loans are associated with promoting industrialization by addressing infrastructure bottlenecks. According to Foster et al. (2008, p.23), loans by BRICs therefore address the annual infrastructure gap in African countries of \$10 billion per annum, which has been estimated to reduce Africa's GDP growth by about 1% (Esfahani and Ramirez, 2003; Calderon and Servén, 2004). Chinese loans might therefore help resolve a crucial bottleneck preventing growth in sectors dependent on existing infrastructure. My research spells out which countries follow which development path, and therefore provides insights into the prospects of lifting millions out of poverty.

Third, many have argued that Chinese loans might undermine democracy in recipient countries as they lack 'good governance' conditions. I provide a different view. My findings provide a major step towards understanding the distributional consequences of different loans. If IMF loans benefit the capital owners who are already rich, but Labor – the numerically largest actor – benefits from BRIC loans, emerging creditors might contribute

to a reduction in inequality. Following Boix (2003) and Acemoglu and Robinson (2006), reducing inequality makes democracy more likely. Chinese loans might therefore have an indirect pro-democratic effect in spite of Chinese intent.

1.7 Plan of the study

The remainder of the study is organized as follows. Chapter 2 presents the theoretical framework that motivates my argument regarding how to explain the variation in borrowing patterns. There, I derive several hypotheses that I test in the subsequent chapters. Chapter 3 verifies whether the fundamental assumptions upon which my theoretical framework rests correspond to reality. I then conduct a statistical analysis of borrowing behavior that proceeds in two steps. In Chapter 4, I present a measurement model that allows me to estimate which country is characterized by which type of coalition. The subsequent Chapter 5 utilizes this classification to test whether the borrowing patterns of developing countries follow the hypotheses derived from my theory. The statistical analysis provides strong evidence that social coalitions explain the borrowing behavior of the 129 countries included in my dataset. To show that these findings are not simply artifacts of the data, Chapter 6 presents qualitative evidence from my fieldwork in Ecuador, Peru and Colombia. There, I document how the political dynamics between social coalitions and governmental decision-makers, along the lines of my theory, explain the borrowing behavior of these three countries. Chapter 7 concludes the study by examining whether BRIC loans are ‘good’ for economic development or democracy.

Chapter 2

A Theory of Sovereign Borrowing

2.1 Introduction

The existing arguments explaining the distribution of BRIC loans are not satisfactory. For example, one popular theory suggests that the Chinese lend money in order to obtain access to natural resources. However, if this were the case, China would not have lent to both resource-rich countries such as Angola and resource-poor countries like Ethiopia. Further, countries that have natural resources exhibit different financial relations with China. For instance, Peru, Colombia and Ecuador all have natural resources. Yet, their borrowing patterns differ widely: Ecuador had not borrowed from the Chinese until 2010, then did so massively. Ecuador also took out additional loans from China in 2011 and 2012. In contrast, Peru borrowed from the Chinese throughout the 1990s, but abruptly stopped this practice after the year 2000. Lastly, Colombia has explicitly rejected loan offers that were extended by the Chinese. In short, it appears that creditors such as the BRIC lend indiscriminately while the recipient's choices vary both across countries and across time. I therefore propose a demand-side explanation for why loan agreements exist between BRICs and some developing countries but not others.

My study is the first to systematically explore the response by developing countries

to loan offers by BRICs. My explanation is based on conflict between economic groups over the following borrowing options: whether to borrow from western governments, from the IMF or World Bank, from private foreign banks, or from emerging lenders. Because the conditions attached to each type of loan differ, each tends to create a different set of relative winners and losers. For example, I show that Finance and Industry tend to profit from IMF loans while Labor loses. In contrast, BRIC loans benefit both Labor and Industry, while Finance loses. By analyzing which coalition dominates politically, and who the government will listen to, I can explain why some governments turn to BRICs while others turn to the IMF or private foreign creditors. In explaining why some governments choose one creditor over another, I propose a theoretical framework that builds on the work by Rogowski (1989) and Frieden (1991).

The remainder of this chapter is organized as follows. Section 2.2 reviews the existing literature of government borrowing in general and with respect to emerging lenders in particular. My analysis will substantiate the need for an alternative theory and derive the criteria for a satisfactory alternative explanation that is subsequently developed. In section 2.3, I introduce the foundations of my theory by defining the domestic actors Finance, Industry and Labor and elaborating on their general interests. I also analyze the four borrowing options – IFI, DAC, BRIC and private loans – and investigate their respective characteristics. Following this, I combine the information on the actors' interests and the loan characteristics in a common framework and analyze the respective distributional consequences to obtain insights into which actor would prefer which type of loan. Following these definitions, Section 2.4 sketches the process of coalition formation and examines what type of loan a particular coalition would prefer. The resulting hypotheses of this theory are summarized in section 2.5.

2.2 Existing work, and my contribution

Why have previous attempts to explain government borrowing from BRICs been unsuccessful? The following discussion of existing literature will focus on the underlying reasons in order to inform my own theory. To do so most effectively, I will analyze existing work first with respect to the outcome to be explained, and then with respect to the explanations put forward to explain the outcome.

2.2.1 The outcome to be explained

One characteristic of developing countries is the lack of sufficient capital and the subsequent need to import it. To obtain capital, the governments of developing countries can choose from several different sources of credit. However, existing literature only focuses on the determinants that explain why governments borrow from a specific creditor in isolation. Thus, we know when developing countries borrow from the IMF (Vreeland, 2007; Copelovitch, 2010*b*) or the private market (Tomz, 2007). However, these works ignore the fact that developing countries have to choose between several creditors: Multilateral organizations such as the IMF and the World Bank, bilateral loans from western countries, bilateral loans from BRIC countries, and private creditors.

What is interesting, though, is that the total amount of debt they can obtain is limited. Just as is the case for private individuals in search for financing to purchase a house, a reverse budget constraint exists for governments: creditors will not extend loans if the country's sustainable level of debt has been reached. That is, once the amount of debt is larger than the capacity of debtor to 'carry' this debt (as measured by their economic strength), no creditor will extend additional loans, as they fear that this debt will either not be serviced or will be defaulted on. Given such a limit of the total amount of debt that can be obtained, a government's decision **for** one creditor is also a decision **against** another. From a borrower's perspective, a maximum debt ceiling introduces an interdependency between the various sources of credit. It is therefore essential to explain the choice *between*

creditors instead of only analyzing the determinants of whether a government will borrow from a specific creditor or not.

I therefore argue that political economists should focus on the choice between sources of credit instead of analyzing the determinants of borrowing from a specific creditor in isolation. Such an approach is necessary to explain why some countries borrow from BRICs instead of the IMF and vice versa – or why some countries decide to borrow a bit from both creditors.

The borrower's choice of lender manifests itself in the resulting debt composition. Economists have pursued the analysis of debt composition both in the private and the public realm. For example, starting with the seminal article by Modigliani and Miller (1958), a vibrant literature studies the determinants of private firms' debt portfolios.

However, with respect to sovereign debt, the literature is limited. Differences in the aggregated value of assets and liabilities denominated in foreign currency have been found to be a cause for variation of countries' vulnerability to financial crisis (Eichengreen, Hausmann and Panizza, 2003). Subsequent research on the reasons for the inability of countries to issue bonds denominated in their own local currency gained significant attention. The so-called 'original sin' increases the risk of financial crises, as a real exchange rate depreciation would make it more difficult to service debt if it is denominated in foreign currency (Eichengreen, Hausmann and Panizza, 2004; Melecky, 2012). Scholars working on the issue of 'debt intolerance,' in turn, have attributed this inability to borrow in local currency to weak institutions and bad policies in emerging economies (Reinhart, Rogoff and Savastano, 2003)¹ .

However, these approaches have only looked at the composition of sovereign bond portfolios. Bonds represent only a subset of financing options, the others being syndicated loans as well as multilateral and bilateral loans. Consequently, the interdependencies between

¹ A parallel body of work has examined differences in maturity structures of debt portfolios as shorter maturities require more frequent rollover of debt, and therefore result in higher volatility (Chamon et al., 2005)

multilateral and bilateral loans as well as bonds are not taken into account. In addition, the portfolios have been analyzed with respect to currency denomination and maturities of the bonds, but not to the identity of the creditor. In other words, Chinese money is considered to be identical to American money, as long as it is denominated in the same currency. However, existing scholarship (for example Woo, 1991, p.158) finds that the identity of the creditor matters even if the financing terms are identical.

In sum, the existing literature on sovereign debt misspecifies the outcome that is to be explained. To address this, I will focus on the choice between creditors instead of explaining the choice for a specific creditor.

2.2.2 The explanations proposed

What explains the distribution of loans between sovereign creditors and debtors? The existing literature focuses primarily on the decision calculus of the creditors to explain the flows of sovereign credit.

For example, scholars analyzing which countries receive IMF loans primarily focus on the supply side. Thacker (1999) and Stone (2004) contend that the IMF is merely an instrument of the US, and lending behavior consequently mirrors the interests of its largest shareholder. More refined analyses have taken private interest groups within the industrialized countries into account. For example, Copelovitch (2010*a,b*) argues that IMF lending follows the interests of the domestic financial sector in the United States, Japan, Germany, the United Kingdom, and France. The IMF lends more money to developing countries to which private banks of G5 countries are highly exposed, as this reduces the risk of a default. In this view, the IMF loans provide a bailout to the private sector actors of its major shareholders. In sum, therefore, IMF lending is explained from a creditors' perspective.

The analysis of which governments obtain debt from private creditors is similarly one-sided. In his influential book, Tomz (2007) argues sovereign debtors are at the mercy

of international private creditors. As only the creditors judge the developing countries' credit worthiness, they alone determine who obtains private capital. Tomz conceptualizes the recipient countries as sovereigns with only one desire: implement policies that please private creditors so as to regain or maintain their creditworthiness.

The examples of existing literature cited above suffer from the fact that they explain the presence of loan agreements solely with the actions of creditors. Debtor countries are typically viewed as a reactionary partner that merely needs resources, regardless of the source. Developing countries are therefore conceptualized as actors without agency.

There are some exceptions that utilize a debtor perspective to explain borrowing decisions. For example, scholars have argued that a government might obtain IMF loans not for the monetary resources. Considering that the conditions attached to IMF loans are costly, governments hope that an IMF program is a "seal of approval" as a signal to potential investors (Aggarwal, 1996; Marchesi, 2003). However, while the recipient has been conceptualized as an active player, these analyses understood debtors only as a single, homogenous entity. For example, Obstfeld and Rogoff (1996, p.350) state that "throughout our analysis, we will treat each sovereign borrower as a single unified entity, 'the country.'"

When explaining IMF lending from a borrower's perspective, other scholars suggest that the IMF conditions provide the recipient government with leverage to implement unpopular economic reforms – such as devaluations or austerity measures – against domestic resistance (Remmer, 1986; Edwards and Santaella, 1993; Vreeland, 2003*b*). For example, Putnam (1988, p.457) states that "international negotiations sometimes enable government leaders to do what they privately wish to do, but are powerless to do domestically ... this pattern characterizes many stabilization programs that are (misleadingly) said to be 'imposed' by the IMF." However, while this line of work acknowledges that there may be domestic interests that are against borrowing from the IMF, these actors are not explicitly analyzed. We do not know who they are, why they oppose the conditions attached to IMF loans, nor what they want instead. We only know of the presence of 'domestic resistance' that

provides incentives to the government to seek an external ally.²

However, extensive literature on a related topic makes a strong case that this assumption is outdated. Works on the political economy of trade (see Rogowski (1989); Grossman and Helpman (1994); Scheve and Slaughter (2001); Hiscox (2002); Baker (2003)) incorporate insights by the Heckscher-Ohlin and Stolper-Samuelson theorems that suggest various actors are affected differently by international flows of trade: some benefit from increased trade because of their position in the domestic economy, while others lose out. Considering these distributional consequences these domestic interest groups have an incentive to lobby their governments. Disaggregating the analysis to examine the effect of domestic interest groups therefore helps to explain government policy decisions. I argue that the political dynamics between domestic interest groups within developing countries are the key to explaining why a government obtains a loan from one source versus another.

2.2.3 Requirements for satisfactory explanation

The analysis presented above reveals gaps in the existing literature that are responsible for the inability to explain the observed patterns of sovereign borrowing. A satisfactory explanation must therefore address three issues: First, the outcome to be explained must be the choice between creditors as opposed to the choice whether or not to borrow from a single creditor. After all, developing countries have several sources of credit available and yet are constrained by an upper limit of total debt that can be obtained, which introduces

² Analysis of the effect of competing domestic interest groups has been used to explain questions related to the IMF. For example, Nooruddin and Simmons (2006) argue that domestic interest groups matter for the distributional consequences of IMF agreements. If the IMF demands spending cuts, it initially does not specify which part of the budget should be reduced. As the eventual budget cuts are a result of negotiations between the IMF and the government, Nooruddin and Simmons argue that there is space for domestic interest groups to influence where the cuts are to be made. They show that in democracies it is the poor that are typically the losers as they are usually not as organized. As they consequently lack political voice they are harder hit by spending cuts (See also Woo (2010) and Conway (2006)). However, these approaches assume that an IMF agreement has *already* been reached, and domestic politics only factors into the secondary decision regarding how to *subsequently* distribute the consequences amongst domestic constituencies. I argue that this makes the second step before the first, as no consideration is given to how the same domestic coalitions might affect the decision to seek out an IMF agreement in the first place.

an interdependency between obtaining debt from one source versus another. Second, under these conditions, an explanation of borrowing patterns cannot be provided from a creditor perspective. Instead, the decision calculus of the recipient country must be at the center stage. It is therefore necessary to examine the incentives faced by the recipient government. In particular, a satisfactory theory must incorporate the preferences of domestic actors to which the government responds. The political dynamics of competing domestic interest groups might drive the government's borrowing strategy. Third, if the government's choice between creditors is to be explained with the preferences of various domestic actors, an approach must start by analyzing the distributional consequences for each actor across each type of loan.

Following the considerations laid out above, I begin by defining the domestic actors Finance, Industry, and Labor. I then introduce the various borrowing options available to the central government and analyze the distributional consequences that each type of loan would have on the three domestic actors. The subsequent analysis of coalitional dynamics results in an explanation regarding when a government has the incentive to borrow from emerging lenders as opposed to traditional lenders.

2.3 Actors, interests, and preferences

2.3.1 Defining actors

The starting point of my theoretical framework is to define the domestic actors to which the government responds. I assume the relevant groups to be Finance, Industry and Labor. In doing so, I follow the work by leading scholars in political economy. For example, Gourevitch and Shinn (2005, p.23) suggest a framework that differentiates between owners, managers, and workers while Rogowski (1989, p.6) divides society into capital, land, and labor. Frieden (1991, p.34), in turn, proposes a framework based on divergent class interests between capital and labor as well as sectoral divisions. Most recently, Pepinsky (2008,

p.439) distinguishes between mobile capital, fixed capital, and labor to explain government policy.

In my theoretical framework, Finance is defined as all domestic actors that own mobile capital goods. These are intangible assets such as stocks or bonds. This comprises banks and domestic investment companies. As such, their income is generated by providing financial services to their clients and from interest on capital investments. However, I understand Finance's capital to be mobile in the domestic sense only. The local financial sector typically does not have the opportunity to leave the country, despite the intangible nature of its assets. After all, its business is typically dependent on a domestic clientele such as individual savers or domestic investors. Further, the local financial sector of many developing countries are characterized by a lack of subsidiaries abroad to which liquid assets could be transferred.

In contrast to Finance, Industry comprises all actors that own immobile capital goods such as manufacturing equipment and other capital necessary to produce tangible products. Hence, factory owners such as manufacturing companies or infrastructure firms represent the vast majority of Industry. I also conceptualize land ownership as a form of immobile capital. Note that in contrast to the United States, the number of firms listed on a stock market in developing countries is small, and the set of domestic investors that are able to purchase these stocks is similarly small. It is therefore generally not the case that employees are also owners of their companies.

Lastly, Labor encompasses all actors who do not own capital and therefore need to sell their labor. The income of this group is therefore entirely comprised of wages³ .

I follow Frieden (1991) in assuming that the role of the government is to aggregate the preferences of domestic actors weighted by their relative power, and, subsequently, implement the dominant policy demands. I assume that the government's main objective

³ At this point, in the interest of parsimony, I assume that Labor is a homogenous unit and do not differentiate between formal and informal work, or skilled and unskilled labor. However, I will relax these assumptions later on.

is to maintain incumbency. It does not have interests of its own regarding the source of credit but merely responds to societal pressures. This implies that my argument does not only apply to democracies, but also to autocrats who are dependent on the continued support of a selectorate.

To conceptualize the government as an ‘area for contestation,’ as opposed to an actor in itself, might appear at odds with the existing literature on “Bringing the State Back In” (Skocpol, Rueschemeyer and Evans, 1985; Schmidt, 2009) that explicitly allows for the state to have its own interests. While I acknowledge that this concept holds appeal, I argue that its applicability in the context of developing countries is limited for two reasons. First, it is not clear whether bureaucracies would have strong preferences with regard to which creditor to choose, and if so, in which direction this interest would point. After all, different ministries might have opposing interests. For example, the Foreign ministry might want BRIC loans in order to avoid conditions attached to multilateral loans thereby increasing its room to maneuver in the international arena. In contrast, the Procurement Ministry might want multilateral loans for the technical expertise that comes with World Bank loans. Second, while bureaucracy is the foundation of the strong states that characterize the East Asian Tigers, the large majority of developing countries can best be described as weak states. Considering the low degree of state capacity, it is unwarranted to assume that states themselves will have interests. Instead, the assumption that states primarily respond to societal interests is reasonable, particularly in the context of recipient developing countries⁴ .

2.3.2 Defining interests

The next step is to determine what these actors want. I therefore examine the political and economic characteristics of each actor to analytically derive both their interests and their preferences. This is an important distinction: Interests are the broad long-term goals

⁴ See chapter 3 for empirical evidence supporting this assumption.

that actors hope to accomplish with particular political actions. In contrast, preferences identify the preferred choice among a specific set of options. For example, it may be in my interest to lose weight - but my preference for accomplishing this goal is to play more sports rather than eat less. In other words, preferences across options mark the preferred means to an end, while the interests define the end itself.

The interests of the actors are defined as follows: I assume that Finance is primarily interested in the stability of the domestic banking system in order to ensure its continued existence. In addition, as inflation would devalue their capital, low inflation is in their interest to ensure stable and continued profits. Lastly, the presence of potential clients to which they can offer their financial services is essential to the interests of Finance. In contrast, Industry is primarily interested in the sufficient supply of production inputs as well as adequate demand for their outputs. In addition, they are concerned with the level of investment as this is their main source of maintaining their sources of income. Finally, Labor's interests amount to an increase in real wages as well as sufficient employment opportunities. In addition, social transfers and anti-poverty programs by external actors would also be in their interest.

2.3.3 Defining preferences

Above, I introduced the actors' respective interests. However, what are the preferences of the actors' across the various borrowing options? The following section combines the information of actors interests with the characteristics of the four borrowing options – multilateral creditors, two types of bilateral creditors, or private sources – to derive the actors' specific preferences. For this reason, I analyze the distributional consequences that each type of loan would have on the respective domestic actor.

Here I assume that domestic actors have expectations regarding the distributional consequences of each loan type: each actor will compare their interests with the characteristics

	IFI creditors	DAC creditors	BRIC creditors	Private creditors
Finance	+	+	-	+
Industry	o	-	+	+
Labor	-	+	+	-

Table 2.1: Distributional consequences by actor.

of each borrowing option. For example, IMF loans come with certain macroeconomic conditions that might benefit some actors more than others. Even though the central government obtains the loans, there are distributional consequences for domestic actors that depend on the characteristics of the creditor. In the process of deciding between loan offers, governments have the political incentive to choose the borrowing strategy that is optimal for their desired winning coalition in order to ensure re-election.

In what follows, I will refer to the relevant literature to identify the distributional consequences of each borrowing option on each domestic actor. Two caveats, though: first, note that I am referring to the *average* tendency of an actor to prefer or dislike a particular loan option. It is therefore possible to find particular circumstances where an actor might have different preferences than indicated here. Second, I consider short-term distributional consequences only and am abstracting from long term effects. After all, an increase in social expenditure – from which Labor directly benefits – might also benefit Finance in the long run by increasing human capital. However, these benefits are not immediate and are highly uncertain. I therefore assume that Finance would disapprove of social expenditure as it does not have direct material benefits in the short term.

The resulting distribution of preferences of the three domestic actors across the borrowing options of the government are represented by Table 2.1.

2.3.4 Preferences with respect to multilateral creditors

Multilateral loans are obtained from multilateral institutions such as the International Monetary Fund (IMF) or the World Bank. These loans are typically inexpensive as their

interest rates are low and maturities long. However, they are characterized by specific conditions and a particular sectoral focus. The conditions attached to multilateral loans follow the prescriptions of the liberal Washington Consensus (Williamson, 2000). They include structural adjustment requirements that aim at improving the Balance of Payment deficit, cutting the budget deficit with austerity measures, and reducing inflation in order to preserve the purchasing power of capital. In addition, so-called ‘good governance’ conditions require the recipient country to increase its standards with respect to transparency and accountability. Due to the mission of multilateral institutions, multilateral loans typically emphasize social purposes such as education, housing or health.

Finance’s preferences with regard to multilateral loans are positive. There are several reasons for this. First, Copelovitch (2010*b*) argues that an IMF loan can limit the risk of financial crises in the recipient country. As such, IMF loans are not only a bailout to banks from industrialized countries that are exposed in developing countries, but also benefit the domestic financial sector. Domestic banks are therefore able to engage in profit-seeking activities that otherwise would not be available. Further, as IMF loans are considered effective in addressing balance of payment problems, the government is less likely to default (Pastor, 1987; Conway, 1994). Such defaults would not be in the interest of Finance, as it would seriously limit its ability to engage with international actors and, for example, to obtain interbank loans. In addition, scholars have argued that some governments will seek out an IMF program in order to implement economic reforms that are unpopular with Labor or Industry. Presumably, though, reforms pertaining to the removal of capital controls, restrictions on exchange rates, and curbing inflation are in the interest of Finance.

The preferences of Industry are likely to be ambivalent with regard to the government obtaining a multilateral loan. On the one hand, austerity measures imposed by the IMF are likely to lower public investment, and therefore reduce work for domestic companies (Conway, 1994). In addition, scholars have found that output and growth tends to contract after signing an IMF agreement, which would indicate that Industry is likely to suffer

(Przeworski and Vreeland, 2000; Vreeland, 2003*a*; Barro and Lee, 2005; Dreher, 2006). However, under conditions of high inflation, the profits of Industry are just as much at risk as those of Finance. It therefore might welcome IMF conditions that curb inflation under these conditions. Thus, while there are some directional effects, the preference intensity of Industry for or against multilateral loans is low.

Labor has negative preferences with respect to the government obtaining an IMF loan. Existing research shows that IMF programs are associated with an increase in inequality (Pastor, 1987; Garuda, 2000), usually as a consequence of a reduction in the income share of labor (Vreeland, 2002). In addition, scholars have noted that welfare spending on the poor is likely to deteriorate under the auspice of an IMF program. For example, Nooruddin and Simmons (2006) show that IMF programs have a negative effect on health and education expenditures in democracies.

2.3.5 Preferences in regards to DAC creditors

With respect to bilateral loans, I distinguish between loans from traditional western lenders and loans from emerging creditors, as their characteristics differ fundamentally. Western bilateral creditors are members of the Development Assistance Committee (DAC) within the Organization for Economic Cooperation and Development (OECD). DAC members have agreed on how bilateral sovereign-to-sovereign capital flows should look. For example, they should be untied transfers to concessional terms with a focus on social expenditure. Nevertheless, it is expected that bilateral loans from DAC countries are rewarding recipients that exhibit ‘good governance,’ which include rule of law, transparency, and other investor-friendly policies. For example, Dollar (2006) and Collier and Dollar (2002) find that donors are increasingly selective with respect to recipient policy. With respect to the bilateral loans from one DAC member, Stone (2004, p.580) writes that “Britain promotes the Commonwealth of Nations, a loose regime that has gradually evolved into a good governance club. For example, South Africa was readmitted to the Commonwealth after the

end of Apartheid, and Zimbabwe was recently expelled after coming under severe criticism for confiscating land holdings.” Also, it is expected that DAC loans are given only if certain ‘good governance’ criteria are met. This has led to an emphasis on loans for the health and education sector.

Considering the good governance requirements, Finance is likely to view DAC loans favorably. After all, it expects that bilateral loans from traditional creditors will compel the government to pursue orthodox economic policies that would benefit Finance. As bilateral funds from traditional creditors tend to be correlated with IMF loans (Rowlands, 2001, see), the policy preferences of the IMF and DAC donors can be assumed to be similar. In addition, Copelovitch (2010*b*) shows that the banking sector in industrialized countries has the ability to direct multilateral lenders to stabilize financial sectors in developing countries. Consequently, it can be expected that these banks are also able to direct bilateral capital flows from DAC countries for the same reason. Finance in the recipient countries should therefore expect similar positive payoffs from bilateral loans as with IMF loans.

The strong association of policy preferences between IMF and bilateral lending suggests that Industry dislikes DAC loans, as it does IMF loans. The emphasis on good governance will make it impossible for governments to pursue an industrial policy akin to that of the East Asian Tigers in the 1980s, aimed at creating comparative advantages for domestic firms (Wade, 1990; Amsden, 1989). In addition to the good governance requirements, DAC countries also place heavy emphasis on social expenditures, such as education and health. While this may benefit the economy as a whole in the long run, it does not provide specific nor immediate benefits to Industry.

In contrast, Labor’s preferences with respect to DAC loans are likely to be favorable, as it will directly benefit from increases in education and social expenditures.

2.3.6 Preferences regarding BRIC creditors

In contrast to DAC member countries, the BRIC lenders are not constrained with respect to their lending conditions. They are therefore not bound by the norms codified in the DAC. This implies that the lending conditions of BRIC loans differ with respect of their terms and repayment options. For instance, BRIC loans have been found to be more expensive than DAC loans (Foster et al., 2008). Also, while DAC countries do not require collateral to secure repayment, the Chinese have required oil as collateral for loans (Mapstone, 2009; Sudan Tribune, 2012). In addition to differences in financing terms, BRICs appear to have a different emphasis on the purpose of the loans, suggesting that there has been an over-emphasis on “social projects” at the expense of building productive capacity (Mwase and Yang, 2012). Further, BRIC loans are not associated with ‘good governance’ requirements, and therefore give the recipient country greater leeway regarding the use of the incoming resources. Also, their sectoral focus appears to be towards infrastructure rather than social projects.

Considering these differences, Finance would prefer if its government would not obtain BRIC loans. As there are no good governance conditions attached, Finance cannot expect the government to move towards their preferred economic policy that emphasizes liberal markets and capital mobility. In addition, the sectoral focus on infrastructure projects would boost public investment, which in turn crowds out private investment - and therefore undermines the clientele of Finance.

In contrast, Industry is likely to be in favor of BRIC loans. As there are no good governance conditions attached to these loans, the government retains room to maneuver to implement industrial policy, which would directly benefit Industry. Their sectoral focus on financing infrastructure projects further suggests that Industry could benefit as domestic firms can expect business via subcontracting.

Labor also has favorable preferences with respect to BRIC loans. If budget loans from BRICs are indeed conducive to an increase in public investment in infrastructure,

positive employment effects are likely. Some observers have raised the concern that the Chinese bring their own labor to build infrastructure projects. However, Mwase and Yang (2012) state that this is not universally the case. Some Chinese construction companies in countries like Tanzania report about 80 percent of employment going to local communities. For example, a recent Chinese investment was reported to have created 3,000 jobs for local workers (Changfa, 2012; Sayila, 2012). However, observers in post-conflict countries (e.g., Angola and Sierra Leone) report lower levels due to the lack of available skilled workers.

2.3.7 Preferences concerning private creditors

Lastly, capital transfers from private sources can take a variety of forms. First, loans can be extended by international private banks in developed economies, most often in the form of syndicated loans. Syndicated loans are extended by a group of commercial private banks (a syndicate) that jointly lend to a single government. Issuing government bonds is a second option for developing countries to obtain capital from private lenders. Bonds are formal contracts between the government and a multitude of individual investors who may be private institutions or even individuals. Private creditors are typically rather expensive for developing countries because of the risk premium required by private creditors. However, they do not carry any conditions and the government is therefore unconstrained regarding the use to which these borrowed resources are put.

Finance is likely to be in favor of its government borrowing from private creditors. For instance, if the government issues bonds, Finance benefits in two ways. First, they are the only domestic group that has the financial resources to purchase these securities. If the domestic financial sector is holding bonds issued by its government, the interest payments of the government on these bonds amount to a transfer of resources collected via taxes from the general population to Finance. In addition, sovereign issuances further expand the already existing bond market for firms, and therefore provide additional opportunities to Finance to offer financial services.

As Industry is comprised of private companies, they, as well, are in favor of the government obtaining debt from private sources. In particular, because the successful placement of bonds is a signal to investors that the business climate and outlook are favorable, Industry itself will benefit from easier access to foreign loans to finance their own operations.

Lastly, Labor will likely have negative preferences with respect to private debt. Workers in developing countries typically do not have the financial resources to purchase bonds themselves. Bonds therefore constitute a transfer of resources away from Labor to both the domestic and foreign financial sector as the interest paid on bonds must be financed with tax revenue.

2.4 The politics of loan choice

2.4.1 Process of preference aggregation

So far, I have derived the preferences of Finance, Industry and Labor across the four borrowing options available to the government. What is left to explain are the demand side as well as the supply side of the process that results in a government's borrowing decision. The former suggests the mechanism by which the preferences of the societal actors are aggregated, while the latter indicates the process by which politicians decide to whose preferences to listen.

Johnson and Salop (1980, p.12) state that “the choice of policy instruments will be influenced by the political power of various [...] groups.” However, conceptualizing a mechanism of preference aggregation with respect to the topic of this study is a challenge for two reasons. First, the issue is characterized by an unordered set of actors, as well as an unordered set of policy choices. It is therefore not possible to align Finance, Industry and Labor in a one-dimensional space according to their ordered preferences. In this respect, the issue of sovereign debt is fundamentally different from the subject of international trade as the actors can very well be aligned along a single spatial dimension of ‘more trade

liberalization' versus 'more trade protection'. In addition, the preference aggregation of the three actors is characterized by a lack of formality similar to what Bearce (2003) has already noted with respect to monetary policy: there are no formal coalition agreements between actors that have similar preferences. In addition, even if preferences of two actors are known to be aligned, we observe surprisingly little active lobbying by the groups that are affected. Any theoretical mechanism of preference aggregation with respect to sovereign borrowing has to take these considerations into account. Faced with this conceptual challenge, I draw inspiration from Downs (1957) who argues that the central goal of each politician is to win or maintain office. Such office-seeking politicians hence have the incentive to cater to multiple constituencies simultaneously in order to maximize the prospect of maintaining incumbency. In such a situation it is advantageous to politicians if their policies can satisfy the preferences of multiple interest groups simultaneously. Drawing on Shepsle (1979), I argue that politicians carefully observe the structural conditions of the domestic economy to infer which actors are likely to have similar interests. Once they have analyzed which two of the three domestic actors have congruent interests, politicians have the incentive to implement policies – i.e. borrowing from the jointly preferred creditor – that satisfy the preferences of two actors at once.

I suggest that politicians observe the overall economic and political environment to determine whether the interests of two actors are congruent. For example, if unemployment is high, Labor can be expected to have similar interests to Industry. After all, just like Industry, Labor would be in favor of increasing investment in order to create employment opportunities. In contrast, under conditions of high inflation, Labor's interests are likely to be congruent with those of Finance. While inflation devalues the capital owned by Finance, it also lowers the real wages of Labor. In sum, depending on the overall state of the economy, the interests of Labor are either congruent with those of Finance or those of Industry.

A similar reasoning applies to the interests of Industry. If the structure of domestic

industry is focused on producing goods for export, the interests of Industry are likely to be congruent with the interests of Finance. As most industries in developing countries are competing in world markets based on price and not quality, it is essential to keep labor costs low. Labor will therefore not be part of the coalition, as was the case in South Korea (Kay, 2002). In contrast, if the structure of the domestic industry is primarily focused on satisfying the demands of the domestic population, Industry's preferences are likely to be congruent with Labor's. After all, Industry has an interest in ensuring that its customers have sufficient purchasing power to buy the products it produces.

Lastly, the congruence of Finance's interests with those of either Labor or Industry also depend on the structure of the economy. For example, if there is a high level of domestic credit to Industry and investments are primarily financed by domestic rather than foreign sources, Finance's interests will be congruent with those of Industry. In contrast, if the domestic financial sector is catering to the general population as customers, it is likely that Finance's interests are similar to those of Labor.

In short, I argue that politicians do the preference aggregation for the various actors. They have the incentive to think in terms of informal coalitions between actors with congruent interests and they can identify the respective coalition present by observing the structural conditions of the domestic political economy. This mechanism of preference aggregation would therefore be consistent with the empirical lack of formal coalitions and yet explain the behavior of politicians implementing policies generally thought to be favored by the dominant actors.

2.4.2 Resulting joint preferences by coalition

Since I assume three actors – Finance, Industry, and Labor – there are three distinctive coalitional possibilities (see Table 2.2). First, Industry and Labor might have congruent interests, leaving Finance to be the single actor. In the spirit of the Varieties of Capitalism literature, I name this possibility the Corporatist coalition. In contrast, the Capital

Coalition Partners	Single Actor	Coalition
Industry and Labor	Finance	Corporatist coalition
Industry and Finance	Labor	Capital coalition
Finance and Labor	Industry	Consumer coalition

Table 2.2: Coalitional possibilities.

	IFI creditors	DAC creditors	BRIC creditors	Private creditors
Capital coalition (Finance + Industry)	+	o	o	++
Corporatist coalition (Labor + Industry)	-	o	++	o
Consumer coalition (Finance + Labor)	o	++	o	o

Table 2.3: Distributional consequences by coalition.

coalition is present if the interests of the capital owners – Finance with mobile capital, and Industry with fixed capital – are congruent. Lastly, I call the coalition between Finance and Labor the Consumer coalition.

Each of the three possible coalitions has a different joint-preference ordering with respect to the borrowing options available to the government. These joint preferences are a function of the individual actors' preferences (see Table 1.3). If both actors agree in their assessment of whether the government should or should not borrow from a particular source, the joint preference will reflect this. However, if the preferences of the individual actors are contradictory, the joint preference of the coalition will be undecided with respect to this borrowing option. The resulting joint preferences of the respective coalitions are represented in Table 2.3.

In turn, Table 2.4 illustrates the pattern of joint preference ordering across the three possible coalitions between Finance, Industry, and Labor. The Capital coalition between Finance and Industry has a strong joint preference for loans from the private market as both actors prefer this option individually. Multilateral loans are preferred over bilateral loans from DAC or BRIC countries, but not as strongly favored as private creditors. In contrast, the Corporatist coalition exhibits a strong joint preference for BRIC loans as both Labor and Industry favor this creditor individually. At the same time, this coalition has a strong preference against multilateral loans. DAC loans and private loans are jointly

Coalition	Single actor	Joint preference ordering of dominant coalition	Country example
Capital coalition (Finance + Industry)	Labor	Private > IFI > (DAC, BRIC)	Colombia
Corporatist coalition (Labor + Industry)	Finance	BRIC > (DAC, Private) > IFI	Ecuador
Consumer coalition (Finance + Labor)	Industry	DAC > (IFI, BRIC, Private)	Peru

Table 2.4: Illustration of joint preference ordering by coalition.

neither liked nor disliked as the individual preferences are not shared by the coalition partner. Lastly, the Consumer coalition shows a strong joint preference for DAC loans, while they are indifferent between multilateral, BRIC and private creditors.

2.5 Resulting hypotheses

The theoretical framework above introduces preferences of the three actors and suggests a process of coalition formation. In this way, a profile of the joint preferences summarized in Table 2.3 was obtained. The variation of the coalitions' preferences across creditors can be utilized to derive specific hypotheses.

I argue that the composition of new loans a country acquires in a particular year can be explained by the type of social coalition that is present in that country. I do not suggest that a country characterized by a particular coalition will always use the preferred creditor. Rather, I argue that, on average, the government will tend to favor borrowing from the creditor preferred by the dominant coalition when making the series of borrowing decisions in a given year. The resulting composition of total new borrowing should therefore reflect the tendency to over-utilize one creditor to the detriment of the others. With respect to the specific coalitions identified, I hypothesize the following:

Hypothesis A1: Corporatist coalition Governments in countries characterized by a Corporatist coalition between Labor and Industry are expected to prefer borrowing from BRICs more than will governments in countries characterized by other coalitions. At the same time, when making borrowing decisions, these governments will be more likely to

dismiss loan offers by traditional creditors, in particular the IFIs.

Hypothesis A2: Capital coalition If a country is characterized by an informal coalition between Finance and Industry, it is classified as a Capital coalition. Governments of these types of countries are expected to prefer borrowing from traditional creditors and exhibit an aversion with respect to BRIC creditors when deciding among competing loan offers. In particular, this type of country is hypothesized to favor private creditors as well as IFIs.

Hypothesis A3: Consumer coalition An informal coalition between Finance and Labor represents a Consumer coalition. Politicians in countries characterized by this type of coalition are also expected to prefer borrowing from traditional versus emerging creditors. In particular, these countries are expected to exhibit a preference for DAC loans.

2.6 Summary

In sum, I explain why some developing countries tend to borrow from BRICs, while others do not. To do so, I propose a theoretical framework that explains how developing countries choose between loan offers. My theory addresses three shortcomings of the existing literature on sovereign borrowing. First, I focus on explaining the choice between several creditors as opposed to examining whether or not a government borrows from a specific creditor. Second, I reject the assumption that borrowing countries are homogenous entities. Instead I disaggregate the state to analyze the preferences of domestic interest groups and how they might determine government policy. Lastly, because of the focus on the choice between creditors as well as the role of domestic political actors, I am able to introduce the analysis of distributional consequence into the explanation of governments' borrowing strategies.

My theory incorporates an analysis of the differences in distributional consequences

of the various borrowing options across several domestic interest groups. I suggest that these distributional consequences determine the preferences of the actors. I then outline a process of preference aggregation that results in an informal coalition between two of the three actors, isolating the single remaining actor. I argue that the government will tend to borrow from the creditor that is preferred by the dominant social coalition in order to gain the political support needed for maintaining incumbency. This approach allows me to predict under which conditions a government of a developing country can be expected to favor borrowing from emerging creditors as opposed to traditional lenders.

Chapter 3

Empirical Support for the Theoretical Framework

3.1 Verifying fundamental assumptions

The previous chapter outlined a theory that explains why some governments of developing countries tend to choose loans from Brazil, India, Russia and China while other governments are more likely to reject their loan proposals. In the process of developing this theory, I have made a series of assumptions. Before proceeding with the tests of the hypotheses that follow from my theory, I need to verify that these fundamental assumptions are appropriate.

The purpose of this chapter, therefore, is to investigate evidence related to the basic tenets of my theoretical framework as a precursor to investigation of several hypotheses derived from my framework. The remainder of this chapter is organized as follows: First, Section 3.2 investigates whether the process of lending is best explained with a demand-side theory or if loans are driven by the preferences of creditors instead. I will argue that the supply of loans can reasonably be assumed to be constant and therefore variation in borrowing patterns must stem from differences in demand. Section 3.3 examines the process

of borrowing more closely. In it, I conclude that politics have ample opportunity to shape the process of borrowing, the outcome of which, therefore, does not reflect a technocratic decision but a political process. Sections 3.5 and 3.5 debunk the notion that politicians care about the cost of loans or the type of project when choosing among competing loan offers. Instead, I show in Section 3.7 that the preferences of domestic interest groups vary and that politicians respond to these preferences by selecting the loan with distributional characteristics that match the preferences of the dominant interest groups.

To provide an empirical foundation to the discussions in this chapter, I draw on a variety of sources. First, I will present statistical evidence from a newly collected dataset about developing countries' borrowing behavior that will be introduced in more detail later (see Section 5.1). Similarly, I will draw on the insights obtained from about 120 interviews with high-level decision-makers which I conducted in Ecuador, Peru and Colombia. Specifics about the case selection and interview method can be found elsewhere (see Section 6.1 while details regarding the questions asked and interviewees can be found in the Appendix A.

3.2 Demand-side vs. supply-side

It might be argued that successful loan agreements are driven by the 'producer' (i.e the creditor) and not the 'consumer' (the debtor). In this case, creditors' willingness to lend to one country, but not another, would explain why some governments obtain loans from a particular creditor while others do not. The debtors' preferences would therefore not be of important as the recipient government would be glad to receive whichever loan it could obtain. In other words, in that hypothesis the process of lending might be driven by the supply side. If this were the case, an explanation based on the demand side – such as the one put forward in Chapter 2 – would be inappropriate as the preferences of domestic interest groups or the government of recipient countries would not matter. In such a case, the 'choice' of developing countries between creditors might not actually be

a choice. Rather, developing countries would be passive recipients of loans that creditors decide to allocate.

In contrast to the supply-side hypothesis, I argue that the demand side is crucial for explaining the lending/borrowing patterns observed. Confronted with the supply-side hypothesis it is therefore necessary to provide empirical support for one of my theory's fundamental assumptions: the supply of loans can be assumed constant while debtors' preferences vary, which, in turn, explains variations in the observed choice of creditor. The purpose of this section is therefore to provide evidence for the assumption that the supply side is not the driving force behind the distribution of loans but that – contrary to conventional wisdom – the supply of loans can be taken as largely constant.

3.2.1 The supply of BRIC loans

With respect to the supply of bilateral loans by Brazil, Russia, India and China, I base my observations on the interviews with both debtor and creditor representatives I conducted in Ecuador, Peru and Colombia. These countries are similar in many respects, particularly in their distance from China, colonial histories, cultural and linguistic backgrounds, and political systems. However, only one of these countries, Ecuador, has borrowed large amounts from the BRICs. Yet, my interviews with public debt officials made clear that not only Ecuador, but also Peru and Colombia had received loan offers from the Chinese. In part, this is because one of the most important Chinese policy banks, the Chinese Development Bank (CDB), maintains offices in the capitals of each of these three countries. For example, the CDB had opened its office in Bogota, Colombia, already in 2007 (Guarin, 2011). Others confirm that the CDB's Peruvian office in Lima is staffed by four permanent employees (Alzamora, 2011; Su, 2011; Ming, 2011). In other words, the physical representation of the Chinese in these three countries is constant.

However, despite their physical presence in these countries, BRICs willingness to lend might still vary. Interviewees representing the debtors suggested that the Chinese strategy

towards the three countries is the same (Paredes, 2011). However, I triangulated this information by conducting interviews with Chinese creditor representatives, such as those from the CDB, in Peru, Ecuador and Colombia. Their answers were consistent across the three countries, confirming that Chinese lending institutions are generally willing to lend. After all, they represent a policy bank with the purpose of lending. I was told that the CDB is, in principle, interested in lending if approached by a government with a project that is in the ‘national interest’ of the recipient. Upon further questioning regarding what constituted a project in the ‘national interest,’ the officials stated that they would be willing to grant loans for undertakings that would increase people’s welfare or make important economic sectors more competitive. In essence, the CDB “is willing to lend to anybody with a good proposal, because we are a development organization, just like the World Bank or IADB” (Ming, 2011).

3.2.2 DAC creditors and the difference between foreign aid and loans

The traditional discourse concerning foreign aid by western bilateral lenders suggests that these lenders have the ability to direct to whom their resources are given. In particular, it appears as if transfers from DACs to developing countries are primarily motivated by the political and strategic considerations of the donors as opposed to the requirements of, or demands from, recipients.

I agree with this assessment – but only with respect to foreign aid. For the purposes of the investigation into sovereign lending, it is important to differentiate between foreign aid and loans. The literature with respect to aid has firmly established that its provision is strongly correlated with the receipt of political favors within international organizations. In other words, foreign aid buys votes. For example, developing countries that became members of the UN Security Council began to receive 56% more aid from western developed countries than those not represented (Kuziemko and Werker, 2006). Dreher, Nunnenkamp and Thiele (2008) show that this relationship particularly describes the behavior of the

United States. Most recently, Bueno de Mesquita and Smith (2010) find that the probability of obtaining foreign aid from the United States increases sharply after a country is elected to the Security Council. Despite the official rhetoric of human rights and development, autocracies are very likely to begin receiving US aid after joining the Council even if they have never been a recipient previously. In addition, Bueno de Mesquita and Smith (2010) show that the recipients of US foreign aid favor US policies during their tenure on the Security Council.

While there is robust evidence for the argument that foreign aid buys votes, I argue that this relationship is different in the context of loans. Foreign aid constitutes a monetary transfer where no monetary repayment is expected. Instead, as shown above, ‘repayment’ is obtained in political terms. In contrast to foreign aid, bilateral loans do contain the provision of repayment in monetary terms (i.e. principal with interest). Thus, in the case of bilateral loans, repayment in votes is not required because a monetary repayment is already expected. Due to this difference in the type of ‘repayment,’ it is not reasonable to expect that the distribution of bilateral loans is strongly shaped by donors’ political interests. Loans are a commercial product that are granted to anyone who can reasonably be expected to repay both principal and interest.

My conversations with French, German and US creditor representatives in Ecuador, Peru and Colombia confirmed that creditors viewed loans as a rather apolitical instrument. In particular, my interviews revealed that the agencies’ missions are to get as much *business* with governments of developing countries as possible. The French representatives were most explicit in stating that “whenever the host country would invite loan proposals we [the Agence Francaise de Developpement] would make an offer on terms that they deemed competitive in light of the expected offers by other creditors” (Richy and Gazon, 2011). Following this statement, the interviewees listed the interest rates and maturities that their competitors such as the GIZ (Gesellschaft für Internationale Zusammenarbeit, the German Development Agency) or USAID as well as multilateral institutions such as the

IADB would typically offer.

In sum, it is important to differentiate between loans and foreign aid. While the latter might very well be driven by supply-side considerations, the commercial nature of bilateral loans in a competitive market indicates that demand considerations are more decisive.

3.2.3 IFI membership and borrowing rights

I argue that the supply of loans by the third type of creditor, International Financial Institutions, can also be viewed as constant. For example, the IMF – arguably the most important creditor to developing countries among the IFIs – is a membership organization with financial resources that are provided by its members via quota subscription. Upon joining, each member country therefore contributes a certain amount of hard currency to the IMF that is largely proportional to the country’s GDP. Currently, the US is the country contributing the largest quota to the IMF (about \$64 billion) while Tuvalu is the smallest contributing member with a quota of \$1.8 million.

These quotas play a key role with respect to the countries’ access to IMF financing. To quote the IMF itself, “the amount of financing a member can obtain from the IMF (its access limit) is based on its quota. For example, under Stand-By and Extended Arrangements, a member can borrow up to 200 percent of its quota annually and 600 percent cumulatively. However, access may be higher in exceptional circumstances” (IMF, 2013*a*). If a country is a member of the IMF it has the right to borrow from the IMF. For IMF member countries, therefore, the supply of loans can be assumed constant.

It is important to understand the country coverage to which this constant IMF supply applies. My dataset contains a total of 129 developing countries over the period of seven years (2003-2010). Of these 903 country-year observations, only 8 country-years were without IMF membership: Kosovo joined the IMF only after its independence on June 29, 2009 and Montenegro only on January 18, 2007 after its separation from Serbia. Apart from these five years that Kosovo was not IMF members and the three years that Montenegro

missed out, all other developing countries were an IMF member during the entire period of my dataset.

When examining IMF membership over a longer time period, the picture remains remarkably similar. When analyzing IMF membership for the same set of 129 countries from 1970 through 2010, in only 667 of a total 5289 country-years were the respective countries not IMF members. This is even more striking considering that 330 of the 667 non-membership country-years can be attributed to the 15 countries emerging from the former Soviet Union (such as Kazakhstan or the Ukraine). After all, they did not have the opportunity to become members until the dissolution of the Soviet Union in 1991.

In sum, the supply of IMF loans can be viewed as constant, as IMF membership is almost universal and IMF members have the right to borrow up to 600% of their quota. However, even though the supply of loans is constant, actual borrowing from the IMF exhibits variation which has received attention from academic scholars. Existing scholarship has attempted to explain this variation in utilizing IMF loans primarily with supply-side arguments. For example, Copelovitch (2010*b*) shows that in the aforementioned ‘exceptional circumstances’ some countries might get larger loans than others. In particular, governments of developing countries, in which private banks from G5 countries are heavily exposed, typically obtain larger loans in times of crisis in order to avert financial crises which would hurt these private financial interests.

I argue, in contrast, that this variation of utilizing the IMF primarily depends on demand-side considerations. Some countries simply do not want to borrow from the IMF, while others do. Considering that the supply of IMF loans is constant, the heterogeneity of debtor preferences also results in variation of observed borrowing behavior. In this case, it is reasonable to assume that the supply of loans by the IMF is constant, which in turn implies that the presence or absence of an IMF loan is largely determined by the demand (or lack thereof) from the potential recipient.

3.2.4 Private creditors and the non-discrimination of borrowers

Private creditors might be considered most fickle in comparison to the other three creditors. After all, the BRICs, DACs and IFIs are public creditors and, as such, can be assumed to respond more slowly to changing market conditions either for bureaucratic or political reasons. In contrast, conventional wisdom considers private creditors to be extremely risk averse, hesitant to extend loans to risky clients, and likely to ‘punish’ bad customers by refusing to do business with them again in the future.

If this assessment of private creditors is correct, we would expect that their lending behaviors exhibit the following characteristics. From a cross-sectional perspective, private creditors would disproportionately favor lending to countries that are in low risk of default and therefore very likely to repay the loan with interest. At the same time, countries with high risk of default should receive very few resources from private creditors. In addition to the cross-sectional perspective examining the decision of private creditors to allocate their resources at a specific point in time, the temporal dimension should also exhibit discriminating behavior by private creditors. Conventional wisdom would claim that private creditors exhibit substantial hesitation when it comes to lending to countries that previously defaulted on their loans. In this paradigm, countries that fail to repay loans would develop ‘bad’ reputations that would prevent them from borrowing from private creditors in the future. I will investigate the accuracy of both perspectives in turn.

The main question implicit in the cross-sectional perspective is the following: do creditors consider the riskiness of countries when making lending decisions? Conventional wisdom suggests that private creditors, in particular, should lend disproportionately to countries with high creditworthiness. At the same time, countries classified as bad risks and, consequently, at high probability of default, would receive comparatively fewer resources. Investor Rating Agencies such as Moody’s, Standard & Poor’s and the Fitch Group provide information on the perceived riskiness of countries. This information is typically summarized in the form of Sovereign Debt Ratings that range from AAA (best)

to D (worst).¹ Conventional wisdom suggests we should expect the ratio of the number of loans to low-risk countries relative to the number of countries in this category to be high. In contrast, countries with low sovereign debt ratings would receive disproportionately few loans.

However, the data do not appear to support this expectation. Figure 3.1 displays the distribution of number of loans by private creditors across the sovereign debt rating of the recipient in the year the loan was received. The graph also displays the absolute number of country-years in the respective risk categories. The figure shows that the number of loans given to countries in any particular type of risk category is proportional to the overall number of countries in this category. If private creditors would favor lending to low-risk governments and discriminate against high-risk countries, the distribution should be such that for highly rated countries the line representing the distribution of loans would be significantly above the bars. Similarly, we would expect that for low ranked countries the line depicting the loan distribution would be lower than the bars. However, this is not the case. In fact, private creditors appear to be lending significant amounts to countries classified as ‘non-investment grade speculative’ (BB range) and even to countries deemed ‘highly speculative’ (B range). Considering this evidence, it can be concluded that with respect to the cross-sectional dimension, the distribution of loans by private creditors does not appear to be discriminating against high-risk countries and favoring low-risk clients. From the cross-section perspective it can therefore be argued that the supply of private loans to developing countries is constant.

I attribute the inadequacy of the conventional wisdom to the lack of attention paid to the flip-side of risk – the reward received in exchange for the risk. In a competitive lending market, higher risk should be rewarded with higher potential returns signified by a higher average interest rate. Considering this proportional relationship between risk and reward

¹ Different rating agencies use the same scale. However, their labels for the respective categories differ. For example, while the top rated category is labeled Aaa by Fitch, Standard & Poor assigns the label AAA to the same category. In the following, I will utilize the classification by Standard & Poor’s.

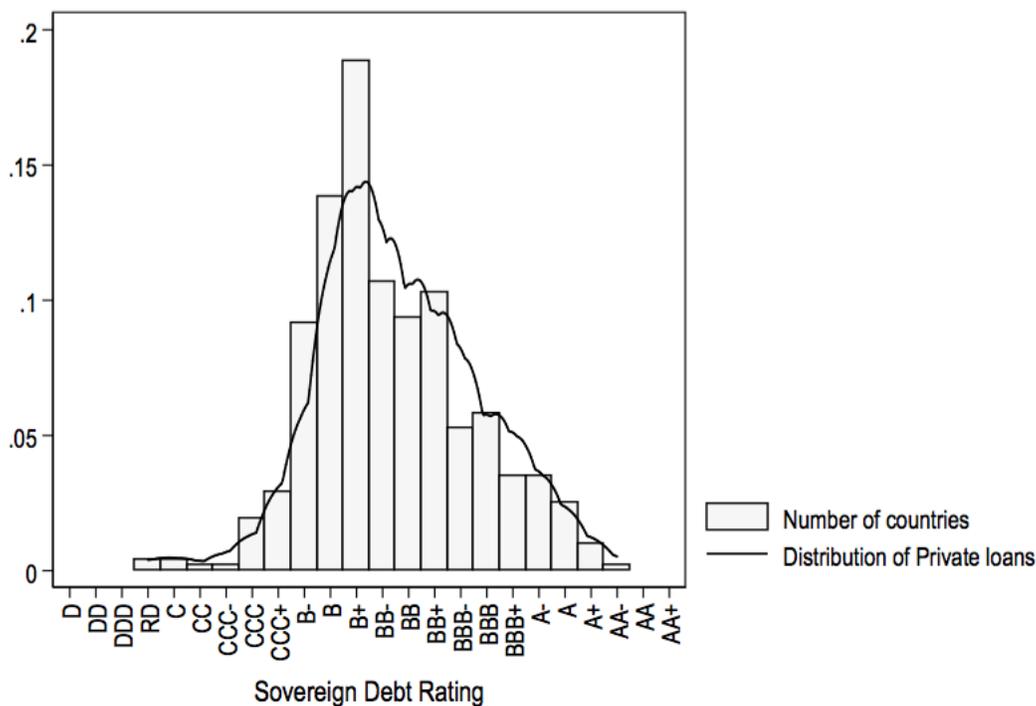


Figure 3.1: Distribution of private loans of any size conditional on countries' sovereign debt rating. The histogram represents the number of countries that received the respective sovereign debt rating.

it appears reasonable to expect that even lower-ranked countries would receive resources from private creditors. In fact, if the loan market were perfectly efficient and interest rates fully compensated for risk, there is every reason to expect that private creditors would be indifferent between granting loans to high or low risk countries. The ratio of countries per classification and number of loans to countries in a given classification should consequently be constant, which is exactly what we observe.

Having analyzed the cross-sectional dimension of lending by private creditors, I now examine how the lending profiles of the other creditors look with respect to the recipients' sovereign debt rating. Figures 3.2, 3.3 and 3.4 display this information for DACs, IFIs and

BRICs respectively. It is telling that neither DAC or IFI creditors appear to be sensitive to the debt rating of their borrowers, for their loan distribution closely matches the distribution of countries across the various sovereign debt ratings. Interestingly, BRICs deviate from the pattern exhibited by traditional creditors. They lend a slightly disproportionate number of loans to countries that are deemed higher-risk.

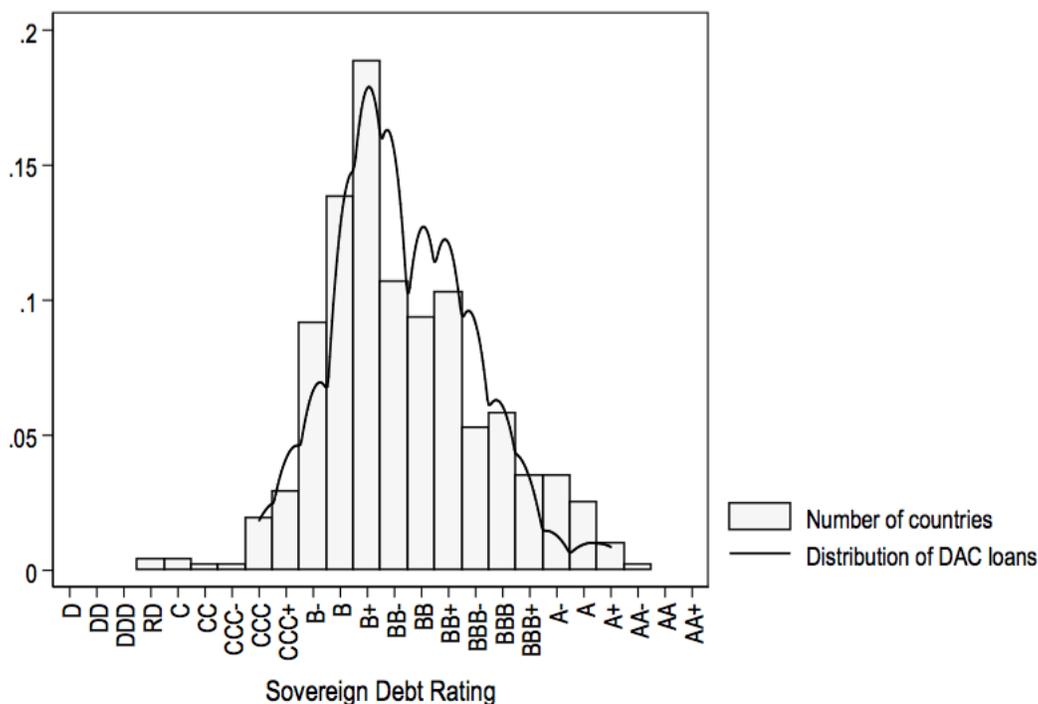


Figure 3.2: Distribution of Private loans of any size conditional on countries' sovereign debt rating. The histogram represents the number of countries that received the respective sovereign debt rating.

Now I will turn to the inter-temporal dimension of loan allocation. In particular, I will examine whether there is a reputational effect that prevents governments from borrowing from private creditors if they have defaulted on loans in the past. If conventional wisdom is correct, private creditors are likely to punish countries for defaulting. A reputational

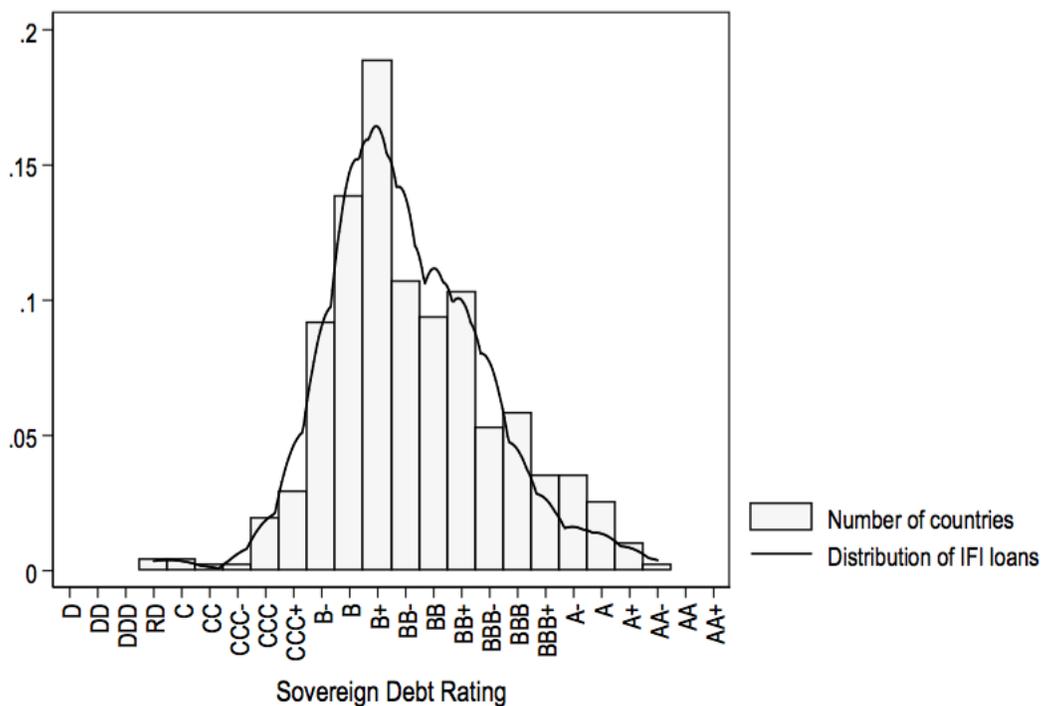


Figure 3.3: Distribution of Private loans of any size conditional on countries' sovereign debt rating. The histogram represents the number of countries that received the respective sovereign debt rating.

effect would therefore deny these countries access to private capital for years to come.

This point of view is prominent in the work on sovereign debt. The canonical formal model by Eaton and Gersovitz (1981) assumes that a country's decision to default will cut them off from the private debt market permanently. Empirical work has lent additional support for this claim. For example, English (1996) notes that among US states in the 1800s, debt repudiation did result in exclusion from private capital markets. More recently, Tomz (2007) argues that Argentina repaid its debt in the 1930s, not in order to avoid a trade embargo from the UK but rather to strengthen its reputation as a good debtor².

² For a contrary account, see (Diaz Alejandro, 1983)

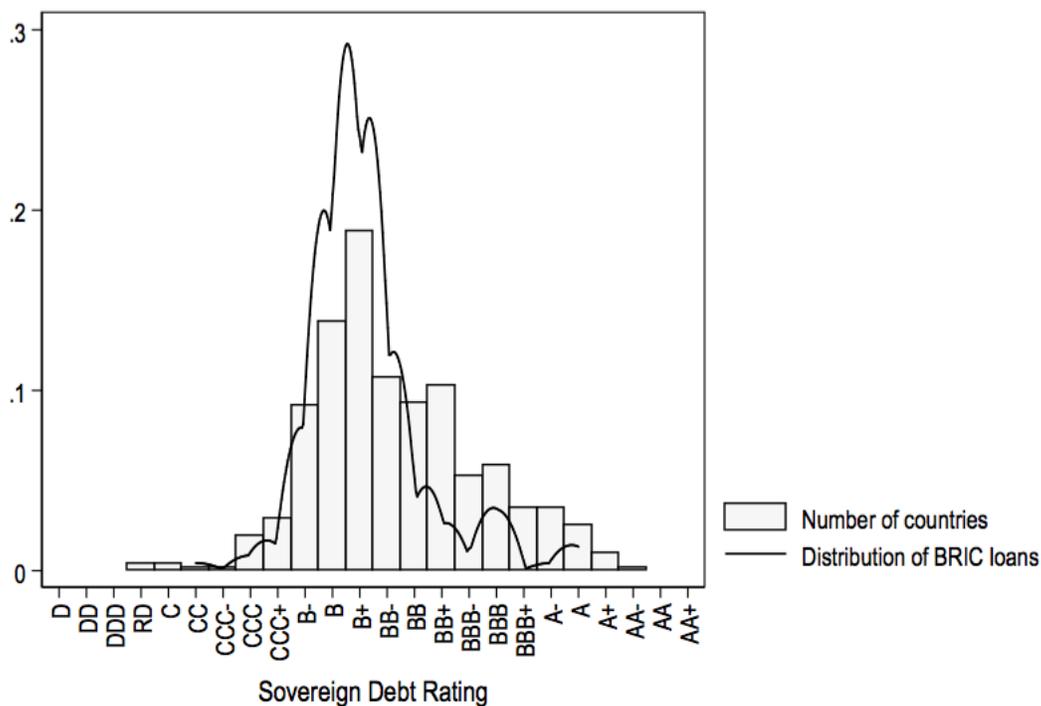


Figure 3.4: Distribution of Private loans of any size conditional on countries' sovereign debt rating. The histogram represents the number of countries that received the respective sovereign debt rating.

However, “whatever were the reasons that led Argentina [...] to repay their debts, there is by now agreement on the fact that default does not lead to a permanent exclusion from the international capital market. In fact, the evidence suggests that, while countries lose access during default, once the restructuring process is fully concluded, financial markets do not discriminate, in terms of access, between defaulters and non-defaulters” (Borensztein and Panizza, 2008, p.13). A significant body of both empirical (Lindert and Morton, 1989; Richmond and Dias, 2009) as well as theoretical (Panizza, Sturzenegger and Zettelmeyer, 2009) work shows that private creditors have “often preferred to repeat the past rather than study it” (Lindert and Morton, 1989, p.39). The most recent econometric study on

the subject concludes that they were “unable to detect strong punishment of defaulting countries by credit markets. The median number of years it took countries to tap the markets after default fell from four years in the 1980s to zero in the 1990s” (Gelos, Sahay and Sandleris, 2011, p.20). They add that “these statistics, together with the results from our panel estimations seem to contradict a common perception that defaults result in very prolonged loss of market access” (Gelos, Sahay and Sandleris, 2011, p.20).

My own data is fully in line with the aforementioned evidence against a repudiational theory that has private creditors punish defaulting countries. In extending data provided by Laeven and Valencia (2008), there were a total of 53 sovereign debt defaults between 1970 and 2010. Figure 3.5 examines how many years after a default the offending country obtained the first loan from private creditors again. The results are striking: in 46 of 53 cases of default, the defaulting country obtained a new loan from private creditors within one year after the default. Note that this analysis only considers debtors obtaining new loans but excludes instances of old loans being rolled over during the process of re-negotiation after default.

The results are comparable for the other traditional creditors. In the overwhelming number of cases both DAC creditors (see Figure 3.6) and IFIs (see Figure 3.7) are willing to lend again to a defaulting country only one year after default. The situation is slightly different for BRICs, as they have not been creditors for a long period of time. Nevertheless, Figure 3.8 indicates that BRICs track record of renewed lending after default exhibits a similar tendency to forgive defaulting debtors quickly.

In sum, default appears to restrict the ability to borrow only in the very shortest of terms. Creditors – regardless of their identity – do not hold a grudge against defaulters. Contrary to the reputational hypothesis, creditors are apparently willing to forgive a defaulting country quickly.

While it is only speculation at this point, I assume that this apparent falseness of the conventional wisdom is, in part, due to a moral hazard problem. If a country reduces

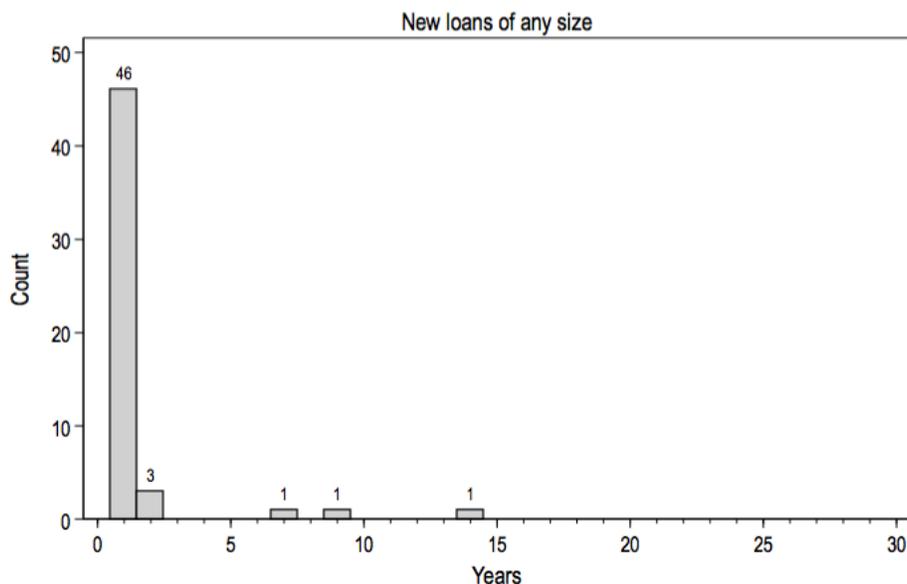


Figure 3.5: Number of years it takes after a country’s default until it borrows again from private creditors, conditional on the amount borrowed.

its overall debt by defaulting on its loans, future creditors might perceive it as less risky post-default precisely because the debt level is again at a sustainable level. In other words, a default might make a country more attractive for creditors because the risk of a renewed default due to an unsustainable debt burden is lowered.

In conclusion, this section has presented evidence in favor of the assumption that the supply of loans can reasonably be expected to be constant. Interviews with BRIC lenders have revealed their desire to lend to “anybody”; the discussion of DAC creditors revealed that loans are viewed as commercial products unlike foreign aid; IFI membership was shown to be almost universal, which together with the right to borrow up to six times its quota implies that access to IMF loans is a given; and, private creditors were shown to *not* discriminate against countries with low sovereign debt ratings or previous defaults. In short, there are convincing reasons to assume that developing countries do have access to

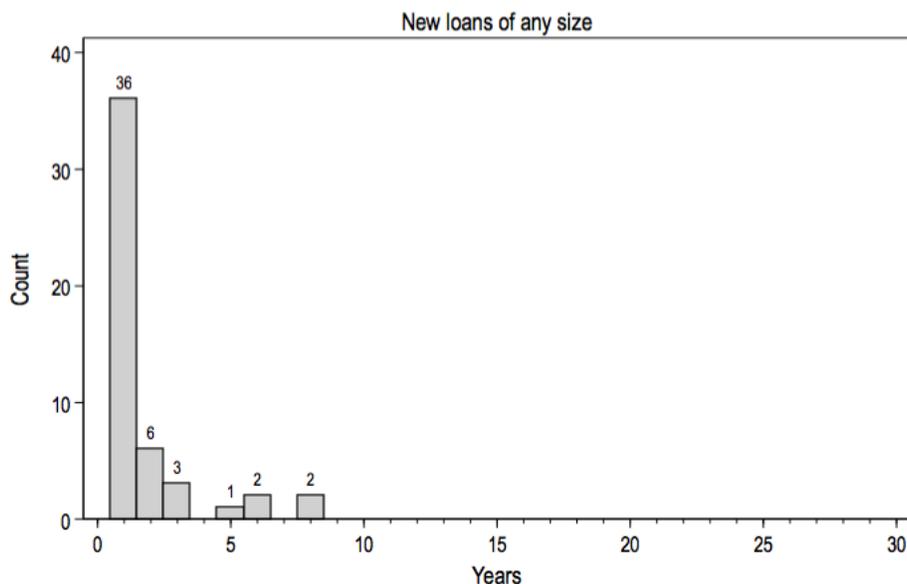


Figure 3.6: Number of years it takes after a country's default until it borrows again from DACs, conditional on the amount borrowed.

any of the four types of creditors if they so desire.

While a demand-side theory explaining the choice of creditor is therefore entirely appropriate, it does not say that there are no supply-side effects. I argue, however, that the supply side assumes a secondary role by influencing the terms on which loans are extended, once the decision for a specific creditor has been made. This would be in line with the existing scholarship. For example, with respect to the IMF, Copelovitch (2010*b*) and Gould (2003) show that the number and type of conditions attached to IMF loans varies with the stakes that private banks from western countries have in developing countries. Similarly, Dreher and Jensen (2009), Barro and Lee (2005) and Thacker (1999) show that the degree of conditionality is inversely related to the recipient country's relations with the US. I will consequently control for these factors in the statistical analysis of borrowing choices in Chapter 5.

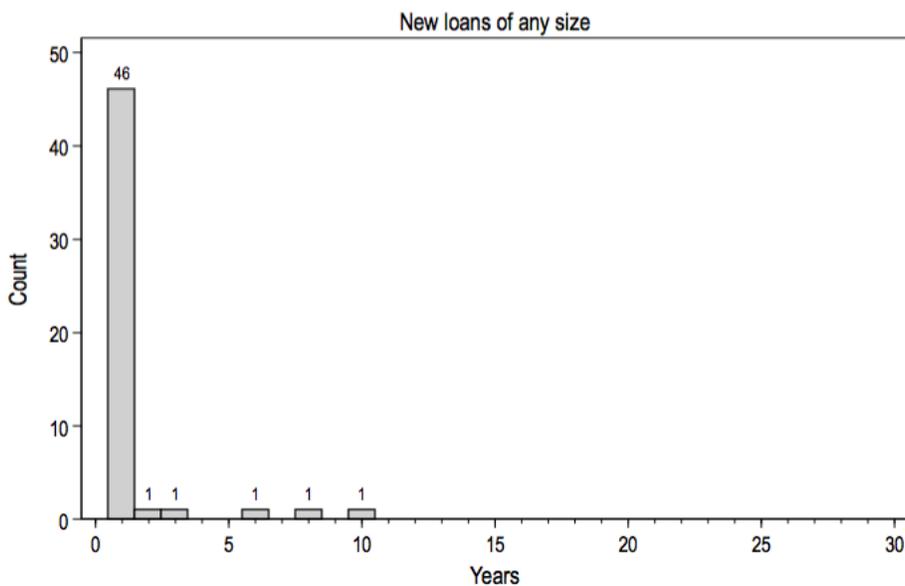


Figure 3.7: Number of years it takes after a country's default until it borrows again from International Financial Institutions, conditional on the amount borrowed.

3.3 The process of choosing among loan offers

While the previous section established that creditors typically offer loans if debtors wish to obtain them, this section triangulates these findings from the debtor perspective. It shows that debtors typically have several loan offers from which they can choose. If governments would not have the opportunity to choose between creditors, a theory focused on explaining the choice between competing loan offers would not be acceptable. In addition, my theory suggests that the borrowing process is shaped by political considerations. This section provides evidence in favor of this assumption by demonstrating the opportunities for politics to impact the decision-making process.

To provide evidence for my assumptions, I will draw on my fieldwork in Ecuador, Peru

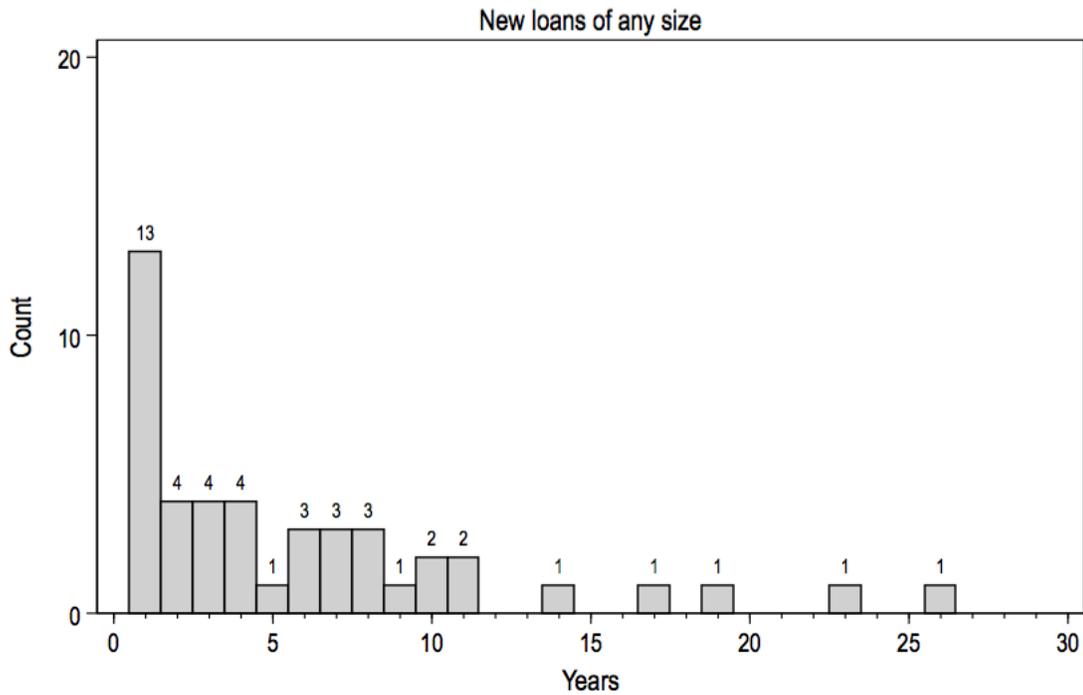


Figure 3.8: Number of years it takes after a country's default until it borrows again from BRICs, conditional on the amount borrowed.

and Colombia. While there, I interviewed public officials working in the Public Debt departments of the respective countries with the intention of understanding the process by which sovereign debt is contracted. By doing so, I was able to learn whether governments have a choice between loan offers and whether politics has opportunities to shape the decision-making process. I will present the evidence collected in Ecuador, Peru and Colombia in turn.

3.3.1 Contracting loans in Ecuador

In Ecuador³, the first step in the process of obtaining sovereign loans is identifying the purpose for borrowing. For example, it may be necessary to borrow for the general budget or to finance a particular project. With respect to the latter, the National Secretary of Planning and Development [Secretaria Nacional de Planificacion y Desarrollo (SENPLADES)] creates a National Investment Plan [Plan Anual de Inversion (PAI)] that includes all projects the government wants to undertake. SENPLADES decides which projects to include based on the viability of the respective projects. Following this step, the Public Debt Office [Subsecretario de Credito Publico] within the Finance Ministry solicits offers from a variety of creditors, such as multilateral institutions, “gobiernos amigos” as well as private creditors. The public debt officials I spoke with stated that Ecuador typically receives several competing credit offers which typically total about 85% of the amount requested.

In order to decide between the offers, the Finance Ministry next evaluates the loan offers received. Interestingly, the financial terms of the offer do not appear to be a major factor in this process. Rather, my interviewees noted that it often is not a question of how expensive these loans are, but whether or not Ecuador can use the loans in a way they would like. Officials do not seem to have formal criteria in place by which to judge the relative benefit of each loan offer. Rather, when I asked why Ecuador suddenly began to accept loan offers by the Chinese, the Ecuadorian debt officer responded that “it was a political decision,” while pointing his index finger upwards.

Once the decision amongst the loan offers has been made, the actual loan contract is negotiated between the Public Debt Office within the Ministry of Finance and the creditor. I was told that Ecuador cannot usually negotiate the terms of the agreement as it is too small of a player to make demands. Once the loan contract has been written, the creditor has to approve and sign it. Following the creditor’s signature, Ecuador has another three

³ The information of this section is based on interviews with the following governmental officials: Peña Villarruel (2011), Anonymous (2011*a*), Villalbo Andrade (2011), and Minoli (2011). Also, Mancero de Viterio (2011).

months to sign the contract on their part.

Within that time frame, the debt contract is evaluated by a variety of political offices within the Ecuadorian government. First, it is presented to the State Attorney [Procurador del Estado] in order to verify that the legal aspects of the contract meet Ecuadorian law. In particular, this focuses on the arbitration clause [cláusula arbitraje] of the contract and assesses whether it allows foreign companies to sue the Ecuadorian government in foreign courts as this would be unconstitutional. If approved and the loan proposal is for \$35 million or less, the Ministry of Finance is authorized to sign the loan right away. However, if the loan amount is larger than \$35 million, the proposal must be presented to a Debt Committee [Comite del Deuda]. This committee has the final say on whether or not the Finance Ministry is to sign the loan. However, the committee is a political body, as its chair is the President of the Republic, even though it is said that he usually delegates this power to the Minister of the Coordinating Ministry of Economic Policy. In addition to the President, the Debt Committee consists of the Minister of Finance, a representative from SENPLADES, a representative of the undersecretary for Public Credit, as well as a secretary from the Debt Committee itself. This relatively small committee of political figures officially only examines whether the loan is consistent with the constitutionally required upper debt limit which requires the overall debt stock of Ecuador to remain below 40% of its GDP. However, it is understood that there are primarily political considerations that play into the Committee's final decision. Once the Ecuadorian actors have approved the loan, the Ministry of Finance is authorized to sign the loan on behalf of the government.

To summarize, the Ecuadorian process of contracting loans provides several opportunities for politicians to intervene. In particular, the Debt Committee [Comite del Deuda] is essentially a political body as its members include Ecuador's President and the Minister of Finance. The quote provided above that "it was a political decision" (Anonymous, 2011*a*) to begin borrowing from BRICs as opposed to traditional creditors speaks to this fact. Considering the process of contracting loans, it should not come as a surprise that the

borrowing outcome would be shaped by political considerations.

3.3.2 Colombia's process of obtaining loans

The Colombian process of signing debt agreements is similar to the Ecuadorian.⁴ The procedure begins with the National Planning Department [Departamento Nacional de Planeación (DNP)], in conjunction with the government, identifying the purposes for which external resources should be obtained. This could be either for general budget purposes or to finance a particular project.

In the case of the latter, the project must be presented to the Economic and Social Policy Council [El Consejo Nacional de Política Económica y Social (CONPES)]. This body is Colombia's senior planning council and is composed of the Vice President, all Ministers, the Director of the Office of the President of the Republic, the Director of National Planning and the Director of Administrative Department of Science, Technology and Innovation. CONPES reviews the viability of the project before the Council for Fiscal Policy [Consejo Superior de Política Fiscal (CONFIS)] then determines how the undertakings should be financed. CONFIS is composed of the Minister of Finance, the Director of Administrative Department of National Planning, Economic Advisor to the President of the Republic, the Deputy Ministers of Finance, the Director of the National Treasury and the Director of Public Credit.

In the next step, the authorization of the Council of Ministers ("El Compes") is required to go proceed with the plans. The council needs to approve the project's alignment with the intentions of the National Development Plan [Plan Nacional de Desarrollo].

Once the approval of the Council of Ministers is obtained, reports of both CONPES and CONFIS are forwarded to the Inter-parliamentary Public Debt Commission [Comision Interparlamentaria de Credito Publico (CICP)]. This Commission consists of six members,

⁴ The information of this section is based on interviews with the governmental officials Rojas Hayes (2011), Benetti (2011), as well as representatives of foreign creditors, Richy and Gazon (2011) and León (2011).

three from the House of Representatives and three from the Senate. The CICIP checks the loans for viability of the financing. Due to the political character of this committee, “it is a complex process. For [multilateral and bilateral debt] we actually have to present it twice to the committee. First to get approval to negotiate for a loan, and once the negotiations are finished we need an authorization to actually hire the debt.” (Rojas Hayes, 2011) It should be noted that the CICIP has the right to veto any external sovereign loan proposal.

After the CICIP has given the government’s request for a loan initial approval, the Ministry of Finance and Public Credit [Ministerio de Hacienda y Crédito Público (MHCP)] is authorized to solicit loan offers. In this regard, public officials repeatedly stated that “we have lots of sources of funding” (Rojas Hayes, 2011).

Once the various creditors have made loan offers, MHCP takes all offers back to the CICIP for a ‘final opinion.’ In particular, the committee must ensure that the loan agreement to be signed does not increase the Colombian debt burden to an unsustainable level.

Once the commission has concluded that the loan offer conforms to Colombian law and policy guidelines, it authorizes the MHCP to sign the loan agreement. If the undertaking was a budget loan, the process stops here. If, however, it is a project that is to be financed, the next step is the organization of a bidding process for the construction of the project. Unlike Peru and Ecuador, Colombia separates the processes of obtaining funding for projects and contracting the construction of the project. This institutional separation of financing and construction of the project implies that so-called ‘tied loans’ are nearly impossible to extend, as they require the debtor to use the loan for the purchase of services or materials from the creditor country. This puts emerging lenders at a disadvantage as they prefer to grant tied loans.

Politics has several opportunities to influence the process of contracting loans in Colombia. This is apparent when considering the membership of the committees whose approval is required: CONPES includes the Vice President and the government Ministers while CONFIS includes the Minister of Finance, the Economic Advisor to the President of the

Republic, and the Deputy Ministers of Finance. In addition, the Council of Ministers' approval is required. The influence of politics on the process of contracting loans is most obvious in the case of the Inter-Parliamentary Public Finance Commission [Comision Interparlamentaria de Credito Publico (CICP)]. As mentioned above, the Commission is composed not of experts in public finance, but of three members of the House of Representatives and another three from the Senate. The interviewees consistently pointed out that this is an essentially political body. As it has the right to veto loan proposals, its ability to shape the borrowing decisions cannot be understated. In sum, as in the case of Ecuador, it is reasonable to expect that borrowing decisions in Colombia are politically motivated.

3.3.3 Borrowing procedures in Peru

The borrowing procedure in Peru is, in principle, similar to those in Ecuador and Colombia.⁵ The process starts with the respective ministry preparing a proposal. For example, the Finance Ministry might outline the need for a budget loan, while a sectoral ministry might propose financing a particular project with external resources. These proposals are then evaluated by the Ministry of Economics and Finance [Ministerio de Economia y Finanzas (MEF)] for viability. If a suggested project is deemed worthwhile, the MEF begins to solicit loan offers. I was told that this process typically results in loan offers from creditors such as multilateral institutions (IADB, IMF), bilateral creditors (in particular, the KfW, JICA, CDF) and private creditors (Felix, 2011).

Once the creditors have reviewed the Peruvian requirements and indicated that they would be willing to extend a loan, the MEF decides with whom it wants to work. Then, the actual loan negotiations begin. These cover the financial terms of the agreement, such as the loan amount, grace period, interest rate and commission, as well as the obligations of the executing agency (i.e. the responsible Ministry). Once this has been accomplished, the Council of Ministers [Consejo de Ministros] – none of whom are bureaucrats of one the

⁵ The information of this section is based on interviews with the following governmental officials: Felix (2011), and Carbajal Vela (2011).

Ministries – signs the loan (Aráoz, 2011).

In contrast to the process of contracting loans in Ecuador and Colombia, the Peruvian process is comparatively straightforward. Once the technical studies are done, the MEF is in charge - and no other ministry is involved (Salhuana, 2011). All necessary functions are centralized. As one official put it, “we have the power. Only the MEF negotiates the actual loan” (Carbajal Vela, 2011). In fact, when asked about the differences between the Colombian and Peruvian borrowing procedures, a Colombian debt officer stated that:

“I have actually spoken with the Director of Public Credit of Peru about the Peruvian debt contracting process. She said ‘You know what we do, we try to convince the government that the Minister of Finance can sign everything’ – and thus [...] they can deal with all of the paperwork inside [the Ministry of Finance] and that makes it easier.” (Rojas Hayes, 2011)

However, while the bureaucratic processes are centralized in Peru, the borrowing process is nevertheless shaped by politics. Similar to Ecuador’s Debt Committee and Colombia’s Inter-Parliamentary Public Finance Commission, the Peruvian process of signing a loan agreement is characterized by an explicitly political body that has the right to veto loan proposals. However, while the Colombian CICP is involved throughout the process of contracting loans, the Peruvian political veto player enters at the very end of the process. The loan is signed by the Council of Ministers [Consejo de Ministros] directly, not a ministry. This implies that the bureaucratic process has to be forward-looking to take the preferences of the Council of Ministers into account. Considering the backward induction necessary, it comes as no surprise that preemptive obedience is common. Just as in Ecuador and Colombia, Peruvian borrowing decisions are therefore also deeply shaped by politics.

3.4 The choice for one creditor as a choice against another

My argument suggests that the decision *for* one creditor is simultaneously a decision *against* another. The purpose of this section is to substantiate the assumption that an interdependency exists between choosing among various loan offers.

The most obvious starting point is to analyze whether debtor governments themselves consider an overall debt limit when making borrowing decisions. After all, if governments self-impose a maximum amount of debt it follows that they cannot accept all loan offers they receive. Such a debt limit would therefore introduce an interdependency where the decision for one creditor is also a decision against others.

My fieldwork uncovered evidence of such self-imposed debt limits. For example, when investigating the process of borrowing in Colombia⁶ the importance of the Inter-Parliamentary Public Debt Commission [Comision Interparlamentaria de Credito Publico (CICP)] became apparent. I also learned that one of the official tasks performed by the CICP is to examine whether the debt to be contracted will increase Colombia's overall debt stock to an unsustainable level. While such a level is not clearly defined, it does suggest that the process of borrowing considers an overall debt limit.

Matters are more evident in Ecuador. Under the influence of past debt crises, Ecuador's current constitution requires that the overall debt stock not exceed a specific threshold. More particularly, the total external debt stock may not exceed 40% of Ecuador's gross domestic product (GDP). Public debt officials in the Ecuadorian Ministry of Finance were aware of this, as the answer to my question regarding where Ecuador currently stands was given without any hesitation: "Our current external debt is at 29% of GDP, as we have a debt stock of \$ 17 million and a GDP of \$70 million" (Anonymous, 2011*a*).

A further observable implication of the claim that governments choose amongst creditors is instances of rejected loan proposals. While we can observe which loans a country

⁶ See Section 3.3

obtains, quantitative data on rejections is typically not available. In fact, obtaining any information on events that were not realized is a challenge. Nevertheless, during my fieldwork I was able to uncover some evidence of instances of governments rejecting loan offers.

For example, Colombia had several opportunities to borrow from the Chinese. For one, the Chinese have been readily available for negotiations as the Chinese Development Bank has maintained a permanent office in Bogota since 2007 (Guarin, 2011). In addition, I was told by several interviewees that loan offers have been extended to the Colombian government. Public officials told me of loan proposals by the China Export-Import bank that were rejected by the government (Chacón Peña, 2011*a*). This was validated by an interviewee who worked for the Ministry of Foreign relations (Garcia, 2011). The economic and commercial counselor to the Chinese ambassador also confirmed that loan offers had been made, but noted that the Colombian government has been hesitant to accept these offers (Quan, 2011).

More specifically, it is known that the Chinese offered to finance several public works projects in Colombia. For example, already in 2005, Colombia wanted to build an alternative to the Panama Canal, a so-called Canal Seco [Dry Canal]. The government solicited foreign creditors – among them, the Chinese – interest in financing this project. The Chinese were initially thought of highly, but they were not selected for the project (Garcia, 2011; Leiteritz, 2011). In addition, government officials confirmed that the Chinese offered a loan to the State-Owned Enterprise ColPetrol. Yet again, this loan offer was rejected (Rojas Hayes, 2011). Thus, the Colombian government had several opportunities to obtain loans from China. Instead, it chose to reject these loan offers and borrow from traditional lenders such as the IMF, western governments and the private capital market.

A corollary of rejected loan offers on the part of the recipient government is the presence of competition amongst creditors. My interviews with representatives of lending institutions in Ecuador, Peru and Colombia confirmed that such competition is real and fierce.

For example, a representative of the German development agency stated that there is competition between them and the Chinese with respect to whose loan offer is accepted by the Ecuadorian government. In particular, there were instances where the Germans wanted to finance particular projects in Ecuador, but lost out to the competing Chinese offer (Rast, 2011). The reverse was the case in Colombia, where a Chinese official implied that their loan proposal had been defeated by a western loan offer (Quan, 2011). This coincides with the information that the Colombian Inter-Parliamentary Commission of Public Debt has in the past rejected loan proposals (Rojas Hayes, 2011).⁷

With respect to multinational lenders, interviewees were undecided whether BRIC loans were crowding out loans from the World Bank or IMF. Some observers stated that there is no competition, as the sectoral focus of projects financed by the World Bank and China differs (Escobar Arango, 2011). However, while a former World Bank representative agreed that the sectoral overlap is minimal, that is beside the point. With limited borrowing capacities, the decision is between creditors, not between sectors (Perry, 2011). Similarly, a former employee of the IMF stated that multilateral organizations are directly competing with the Chinese (Steiner, 2011), an assessment that was shared by Colombian officials in particular (Martinez, 2011).

Bilateral lenders are also aware of the competition. When interviewing representatives of the French Development Agency [Agence Francaise de D/veloppement, AFD] I asked whether they felt it necessary to compete with other creditors. In their view, this was indeed the case. In fact, the conversation then turned into a comparison between the loan offers the AFD typically makes to governments of developing countries and those of its competitors. For this purpose, the interviewees were explicit about the information they had about their competitors. With respect to the interest rate, for example, the AFD charges LIBOR plus 120 basis points, which is the same rate as demanded by the CAF [Corporation Andina de Formento]. Larger institutions such as the World Bank or the

⁷ However, it was not possible to obtain further details on the loans that the Commission rejected as their records are not public

IADB charge LIBOR plus 100 basis points and 90 basis points, respectively, but – as was pointed out repeatedly – attach somewhat more stringent conditions than the AFD. The knowledge of their competition was impressive.

In sum, there appears to be much evidence that an overall debt limit that would introduce interdependency amongst creditors. The debt limits institutionalized in countries borrowing processes, instances of governments rejecting loan proposals and creditors being aware of the competition amongst themselves all point to the conclusion that a government's decision *for* one creditor is simultaneously a decision *against* another.

3.5 The cost of loans and loan choices

The purpose of the previous sections was to verify the assumption that a demand-side theory is the appropriate approach to explain the presence or absence of loans from various creditors. I have shown that the credit supply can be assumed constant and that debtors have a choice between loan offers. However, how do debtors decide among competing loan offers? My theory suggests that decision-makers will utilize political criteria, namely the distributional consequences of a loan with respect to the politically dominant coalition. However, it might reasonably be argued that countries faced with competing loan offers simply choose the cheapest option. In this case, politics would not explain which loan is chosen but rather mere economic considerations would determine borrowing choices. If this alternative explanation were to be verified, the data on existing borrowing patterns should indicate that debtors, by and large, choose the cheapest loan available.

The task of verifying whether this is the case, though, is a challenge. The reason is that we can observe only loan amounts and conditions of loan agreements that were realized, while the conditions of the competing loan offers that were not chosen remain unobserved. Ideally, one would gather systematic data on the loan conditions of *all* loan offers on the table for all countries at any point in time when a borrowing decision is made. However, such individual country-year data is not available, and it is therefore difficult to make direct

inferences on whether or not the cheapest loan offer was chosen.

In absence of such data, a second-best approach would compare the loan conditions of the loans realized across all borrowing instances. If a competitive market of borrowing exists, we should observe that most loans obtained exhibit similar loan conditions due to the price competition among creditors. In fact, it would be irrational for countries to borrow at the more expensive terms than otherwise available. We would therefore not observe that loans were obtained to significantly more disadvantageous conditions.

However, the data on the actual loans realized does not square neatly with these expectations. One criteria that measures the cost of loans is the grace period. The grace period is a time frame typically starting immediately after the loan is signed. During this period, no interest is charged. More importantly, the grace period indicates the time interval to the first repayment of capital: it signifies a certain breathing space in which the loan can be put towards productive undertakings whose earnings are then used to repay the loan. The longer the grace period, the more advantageous to the debtor. Figure 3.9 displays the grace periods of loans obtained from BRICs, DACs, IFIs and private creditors. It appears that the average grace periods on loans obtained from BRICs, DACs and IFIs do not differ much. However, countries also chose to borrow extensively from private creditors, even though their loans are comparatively more expensive as measured by the grace period.

A related measure of the cost of a loan is its maturity, which refers to the time the borrower has to repay the loan. Longer maturities therefore imply a longer time period until the final repayment installment for the loan. In this sense, a loan is more expensive if its maturities is shorter than comparable offers. Figure 3.10 displays the maturity of loans contracted from the four types of creditors under consideration. Traditional creditors appear to grant loans to particularly favorable maturities, with BRIC creditors falling somewhat behind but still offering loans with comparatively long maturities. However, if countries borrowed from private creditors, the maturities granted were particularly unfavorable.

The cost of a loan can also be measured by the interest rate charged. Being the

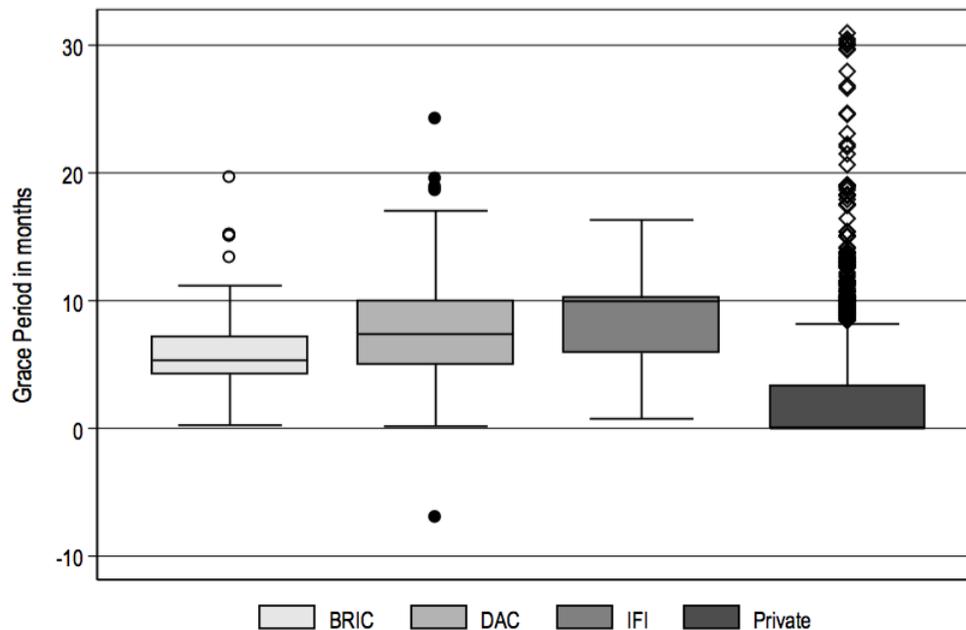


Figure 3.9: Average grace period by creditor. Note longer grace periods are favorable to the debtor.

most straightforward measure of borrowing costs, higher interest rates imply a higher cost of borrowing to the debtor. Figure 3.11 again displays that the interest rates on loans obtained from BRICs, DACs and IFIs do not differ much. While the contrast is not as stark as with grace periods and maturities, private creditors nevertheless demand higher interest rates on average than official creditors.

The various measures of the cost introduced above are summarized by the grant element of a particular loan. It measures the ‘softness’ of the loan by translating grace period, maturity and interest rate into a measure of the concessionality of a loan. More specifically, it is calculated as “the difference between the face value of a loan and the discounted present value of the service payments the borrower will make over the lifetime of the loan, expressed as a percentage of the face value” (OECD, 2010)[see also (IMF et al., 2003, p.250)]. Figure

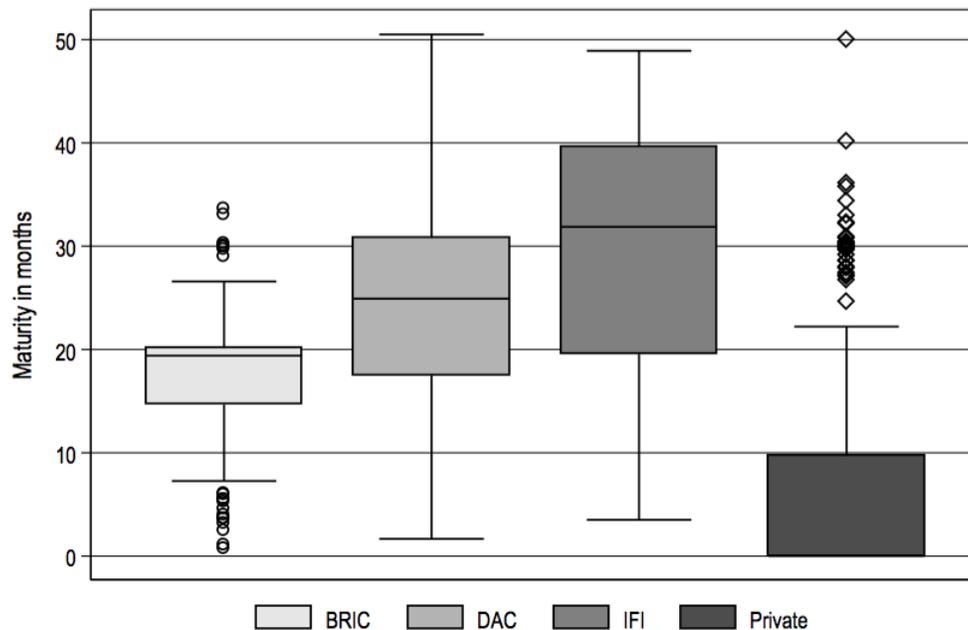


Figure 3.10: Average maturity by creditor. Note: longer maturities are favorable to the debtor.

3.12 displays the grant element implicit in the loan conditions from the four types of creditors. It is again apparent that the grant element of BRICs, DACs and IFIs do not differ much, while the degree of concessionality of private loans is significantly lower.

Therefore, the average cost of loans obtained does not support the hypothesis that debtors always choose the cheapest creditor. If this were the case, private creditors would represent a particularly unappealing choice for debtors, which stands in stark contrast to the observed borrowing from private creditors.

One might argue that comparison of loans granted on separate occasions is not appropriate to judge the relative cost of loan offers available when a single borrowing decision is to be made. Due to the lack of data on the loans that were not chosen, I resort to a

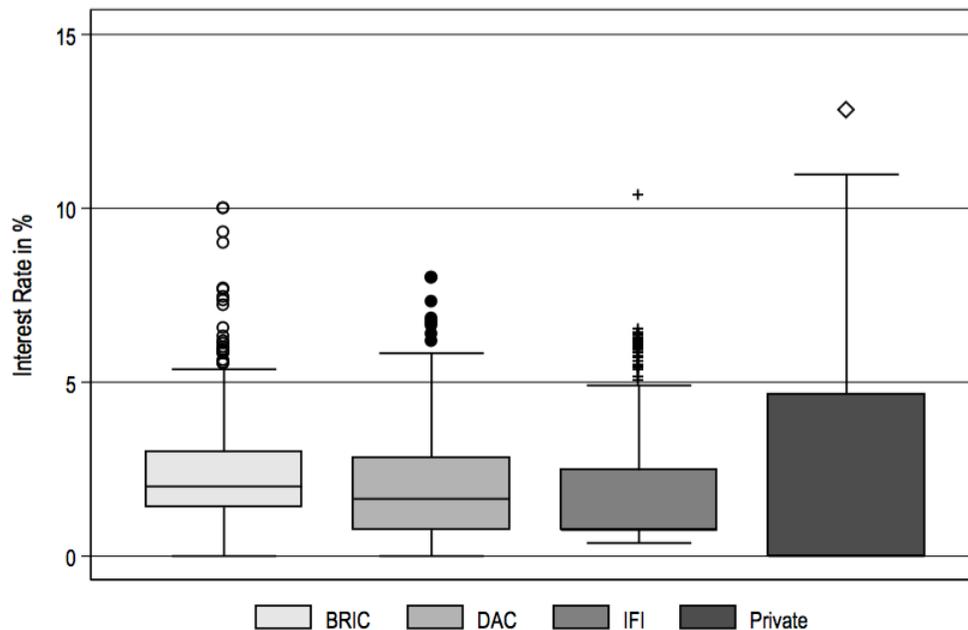


Figure 3.11: Average interest rate by creditor.

second-best approach. In order to approximate the conditions of loans that were not chosen, I calculate counterfactual loan offers for each actual loan agreement made. I used the following procedure to obtain such counterfactual estimates: Assume that country A whose creditworthiness is rated with BB+ by the rating agencies in a particular year obtained a DAC loan in that year. To obtain a counterfactual for the DAC loan actually obtained, I calculate the mean interest rate of loans granted by BRICs to all countries that are also classified as BB+, except country A. I repeat this procedure for IFIs and private creditors, and for each measure of loan conditions available (i.e. interest rate, grace period, maturity, and grant element). I reiterate this procedure for each loan that any country in my dataset obtained at any point in time.

The counterfactual loan conditions obtained this way represent the average market conditions for countries that chose one type of loan when faced with alternative loans,

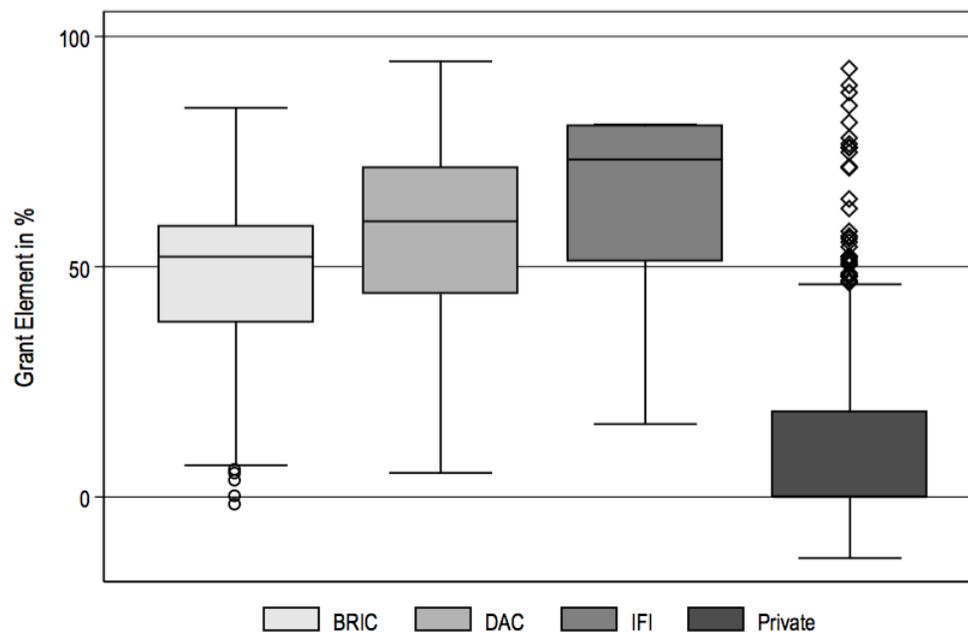


Figure 3.12: Average grant element by creditor. Note: higher grant elements implies a ‘cheaper’ loan.

conditional on their creditworthiness. These counterfactuals, as imperfect as they may be, allow me to approximate the conditions of loan offers that countries faced when they made their borrowing decision.

Figure 3.13 compares the grace period of a particular chosen

This impression is further confirmed when considering the differences between an actual loan and counterfactual loans with respect to their maturities (Figure 3.14), interest rates (Figure 3.15) and grant element (Figure 3.16). Official creditors offer more advantageous terms, in particular the IFIs, while private creditors appear to be the most expensive option.

The Figures 3.13, 3.14, 3.15, and 3.16 present aggregate evidence against the hypothesis that countries always choose the cheapest loan. In addition, the counterfactual analysis

allows me to look at individual borrowing decisions. Table 3.1 provides a summary of borrowing decisions with respect to the relative costs of loans. It displays the absolute and relative frequency with which countries have chosen a particular creditor, *despite the fact* that the creditor chosen offered the most expensive terms in comparison to the counterfactual offers by the remaining creditors. For example, in 28 instances countries decided to obtain their largest loan from BRICs even though the grant element implicit in the counterfactual loan offers by DACs, IFIs and private creditors were higher. Similarly, in 24 instances countries chose to borrow from the IMF even though in comparison to the counterfactual loan offers from BRICs, DACs, or private creditors, it was the most expensive option. The figures are even more staggering with respect to private creditors. Using the grant element as the measure of loan costs, in 157 instances countries chose to borrow from private creditors even though they represented the most expensive choice in comparison to BRICs, DACs or IFI loans. To provide further insight, these instances of countries borrowing from the most expensive (as measured by the grant element) creditor are listed in Table 3.2.

	Frequency	Percent
Most expensive defined by grant element		
BRIC largest loan	28	12.96
DAC largest loan	7	3.24
IFI largest loan	24	11.11
PRI largest loan	157	72.69
Most expensive defined by interest rate		
BRIC largest loan	9	10.98
DAC largest loan	3	3.66
IFI largest loan	2	2.44
PRI largest loan	68	82.93
Most expensive defined by grace period		
BRIC largest loan	37	23.12
DAC largest loan	9	5.62
IFI largest loan	32	20
PRI largest loan	82	51.25
Most expensive defined by maturity		
BRIC largest loan	26	13.13
DAC largest loan	6	3.03
IFI largest loan	29	14.65
PRI largest loan	137	69.19

Table 3.1: Number of countries that chose the respective loan even though it was the most expensive relative to their counterfactual loan offers.

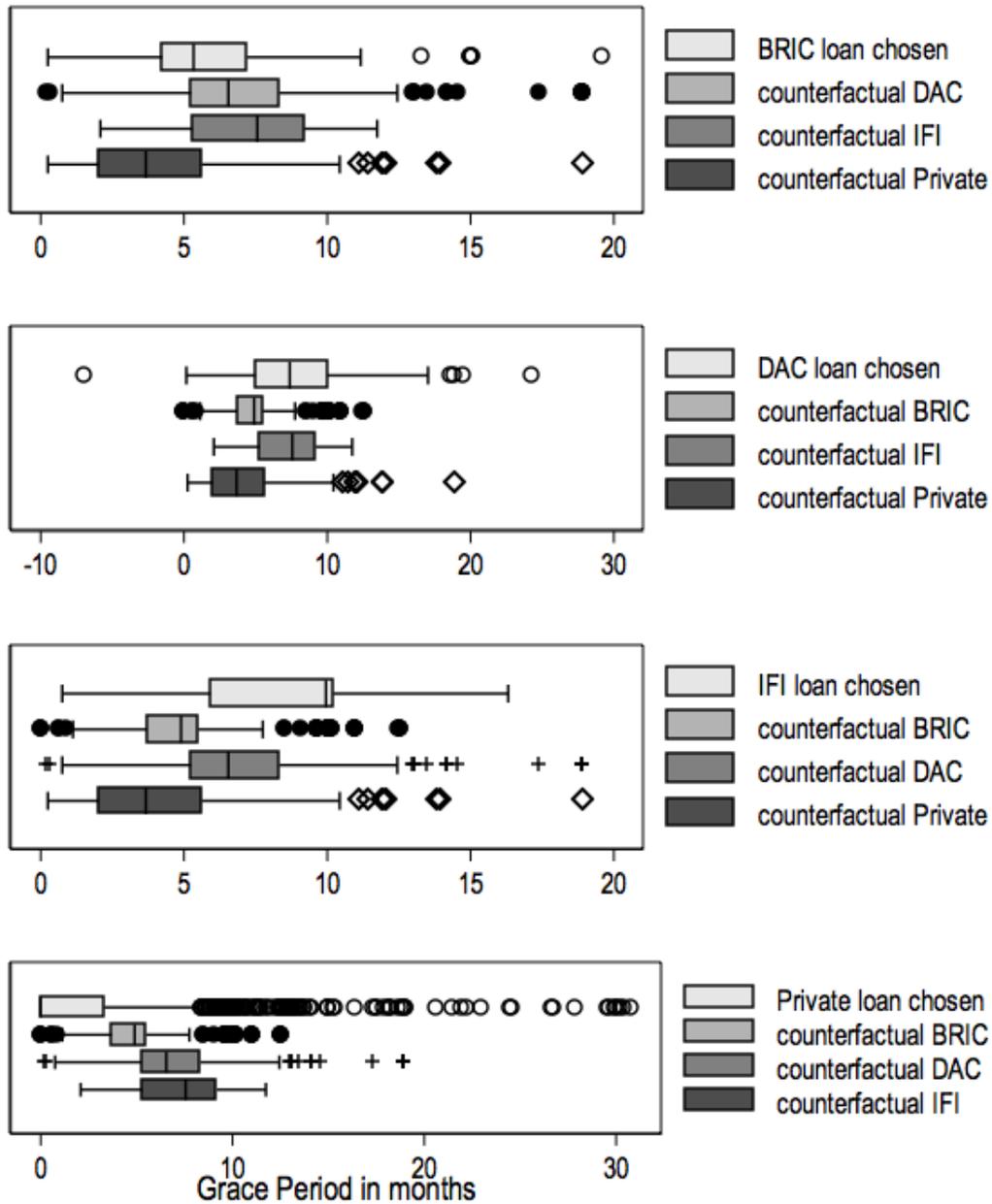


Figure 3.13: Comparison of grace period of loans obtained vs. the counterfactual loan conditions of the alternative borrowing options. Note: longer grace periods are favorable to the debtor.

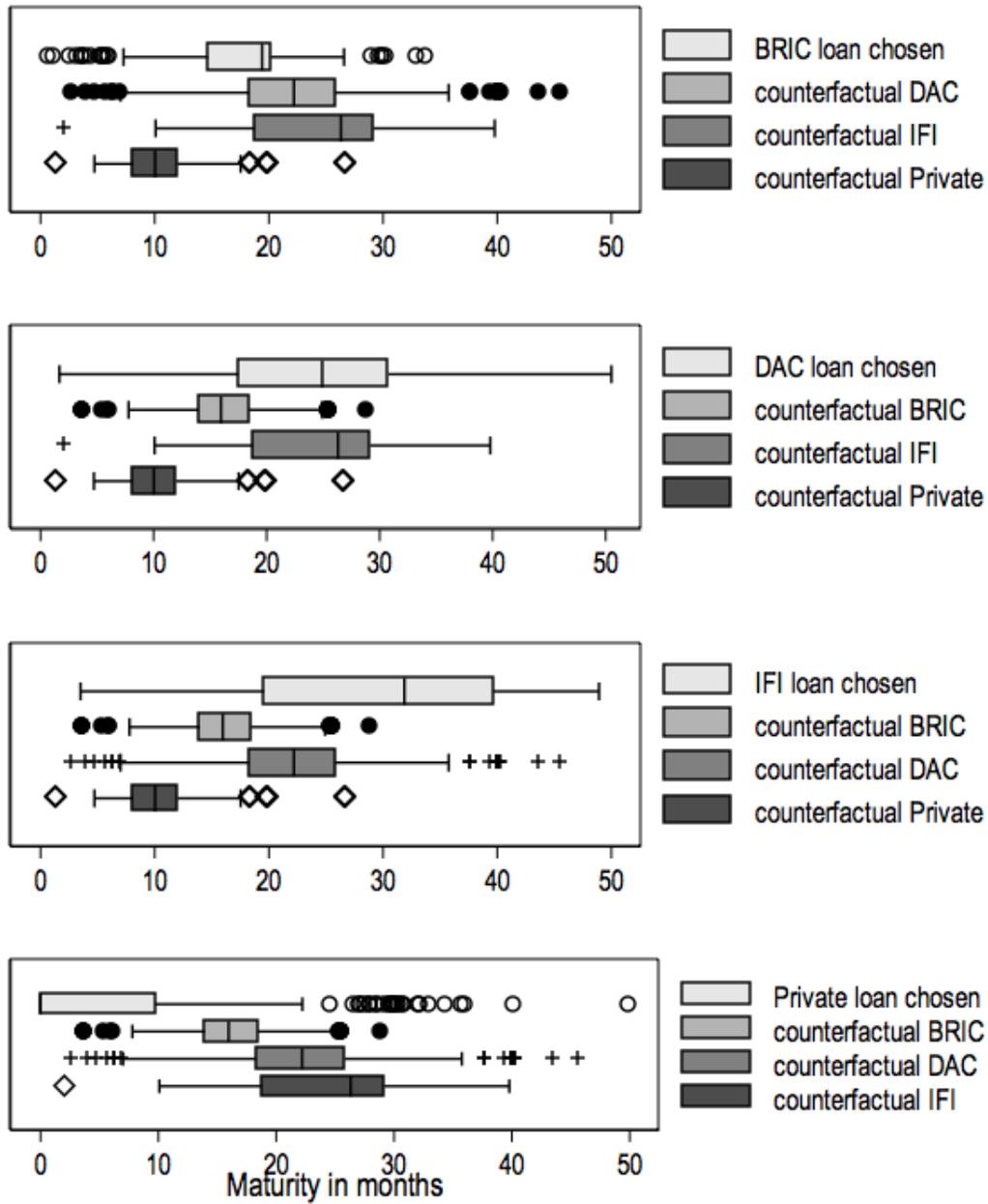


Figure 3.14: Comparison of maturities of loans obtained vs. the counterfactual loan conditions of the alternative borrowing options. Note: longer maturities are favorable to the debtor.

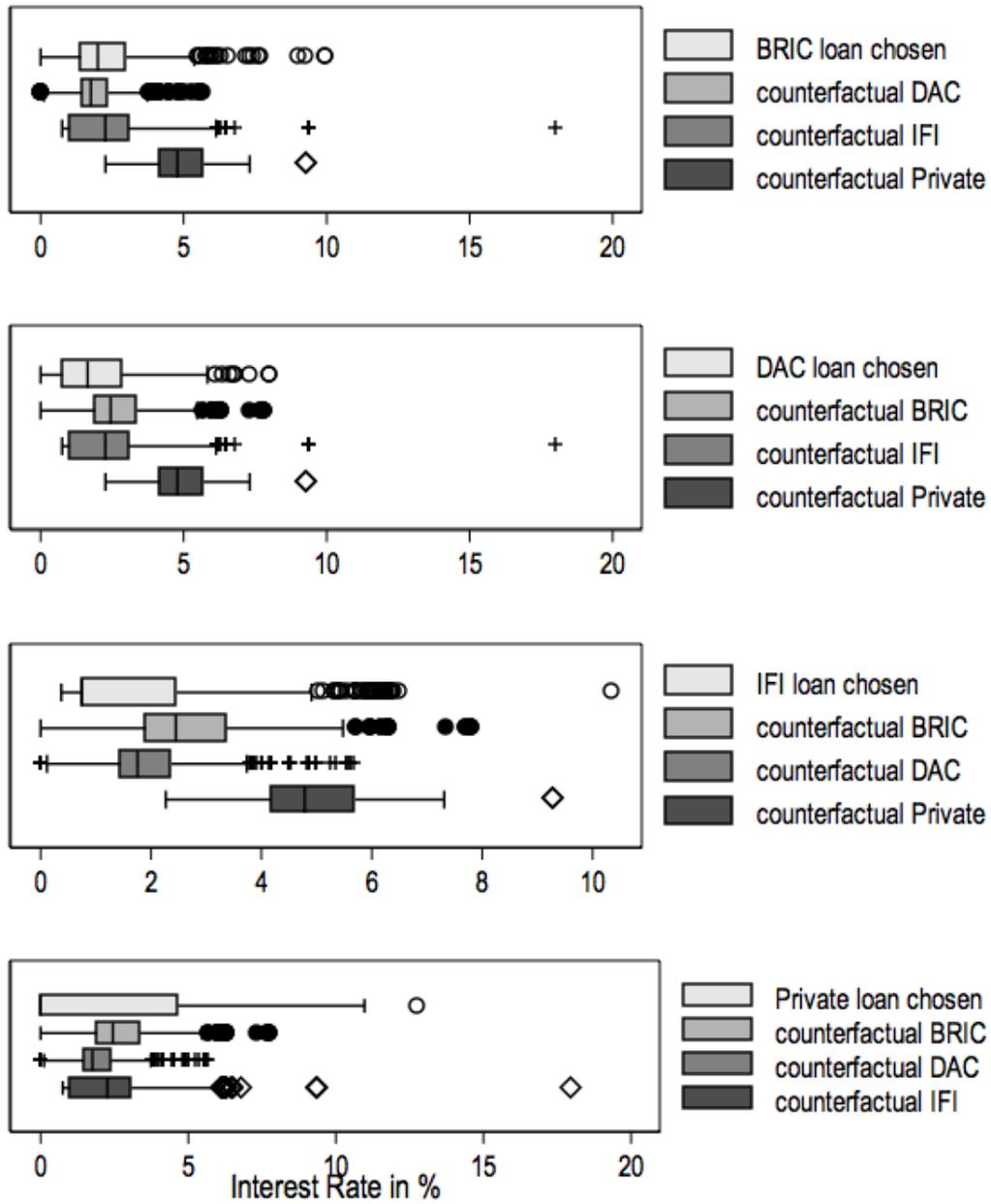


Figure 3.15: Comparison of interest rate of loans obtained vs. the counterfactual loan conditions of the alternative borrowing options.

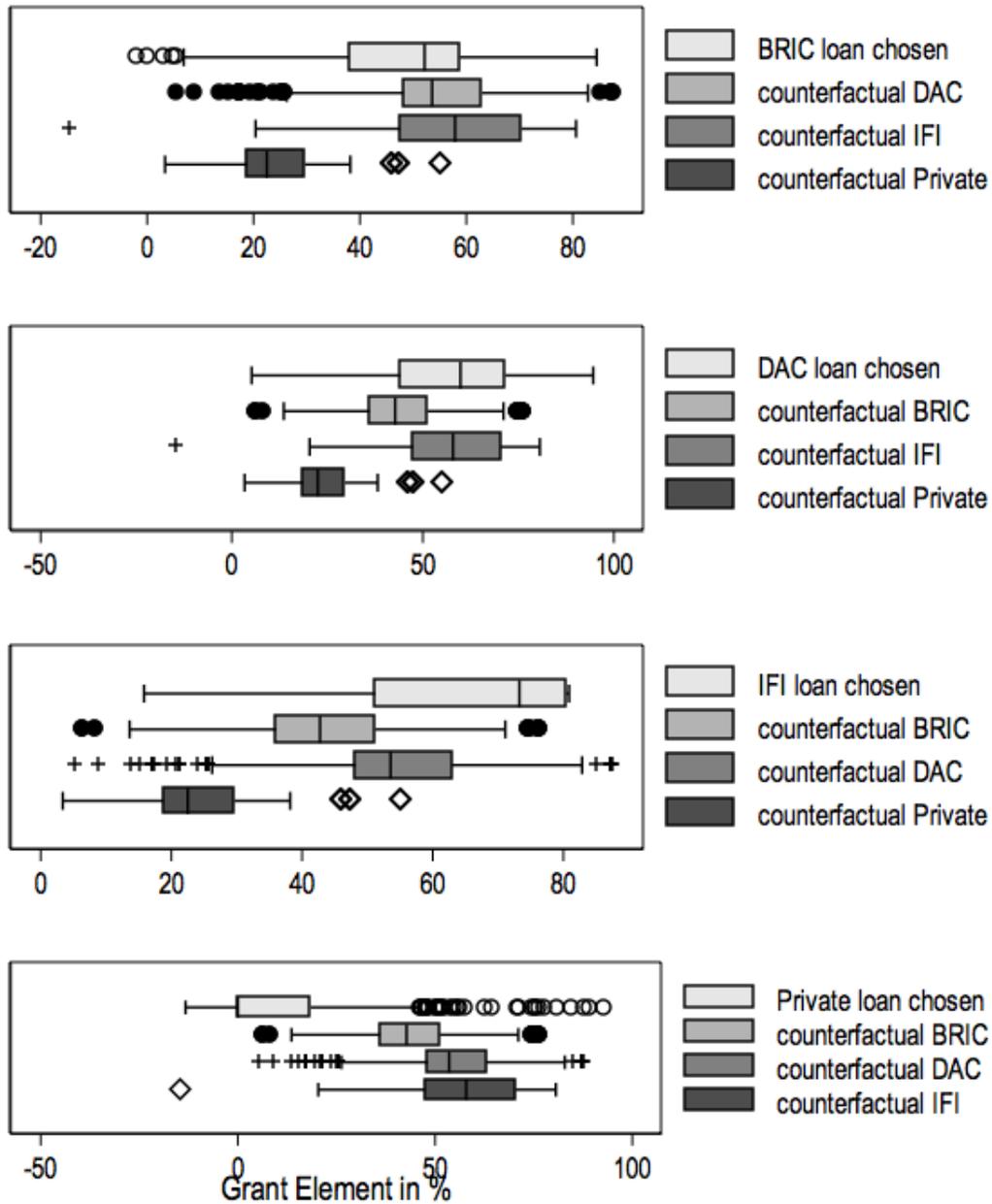


Figure 3.16: Comparison of grant element of loans obtained vs. the counterfactual loan conditions of the alternative borrowing options. Note: higher grant elements implies a 'cheaper' loan.

BRIC	DAC	IFI	Private	India (2007)	Lebanon (2009)	Papua New Guinea (2005)	St. Vincent (2005)
Angola (2004)	Bulgaria (2008)	Argentina (2004)	Albania (2008)	India (2007)	Lebanon (2010)	Papua New Guinea (2006)	St. Vincent (2008)
Angola (2005)	Congo, Dem Rep. (2010)	Argentina (2005)	Albania (2009)	India (2008)	Lithuania (2004)	Paraguay (2004)	Thailand (2004)
Angola (2006)	Morocco (2006)	Argentina (2009)	Albania (2010)	India (2010)	Lithuania (2008)	Peru (2004)	Thailand (2005)
Angola (2010)	Morocco (2009)	Bolswana (2009)	Algeria (2004)	Indonesia (2006)	Lithuania (2009)	Peru (2005)	Thailand (2006)
Belarus (2004)	Thailand (2010)	Bulgaria (2007)	Algeria (2007)	Indonesia (2007)	Lithuania (2010)	Peru (2007)	Thailand (2009)
Belarus (2005)	Tunisia (2010)	Costa Rica (2005)	Algeria (2008)	Indonesia (2008)	Lithuania (2010)	Peru (2009)	Tonga (2009)
Belarus (2007)	Vietnam (2009)	Costa Rica (2007)	Algeria (2009)	Indonesia (2009)	Macdonia (2005)	Peru (2010)	Tunisia (2004)
Belarus (2008)		Costa Rica (2008)	Algeria (2010)	Indonesia (2010)	Macdonia (2009)	Philippines (2004)	Tunisia (2005)
Belize (2006)		Dominican Rep. (2007)	Angola (2007)	Iran (2004)	Maldives (2005)	Philippines (2005)	Tunisia (2006)
Belize (2008)		Dominican Rep. (2008)	Angola (2008)	Iran (2005)	Maldives (2007)	Philippines (2006)	Tunisia (2007)
Bhutan (2004)		Dominican Rep. (2008)	Angola (2009)	Iran (2006)	Mauritius (2004)	Philippines (2006)	Tunisia (2007)
Bhutan (2007)		Ecuador (2006)	Angola (2010)	Iran (2007)	Mauritius (2005)	Philippines (2007)	Turkey (2007)
Bhutan (2010)		Ecuador (2008)	Argentina (2006)	Iran (2008)	Mexico (2004)	Philippines (2007)	Ukraine (2004)
Bolivia (2008)		Egypt (2006)	Argentina (2007)	Iran (2009)	Mexico (2005)	Philippines (2008)	Ukraine (2006)
Bolivia (2009)		Egypt (2007)	Argentina (2008)	Iran (2010)	Mexico (2006)	Philippines (2010)	Ukraine (2007)
Bolivia (2010)		El Salvador (2006)	Argentina (2008)	Iran (2011)	Mexico (2007)	Philippines (2010)	Uruguay (2006)
Brazil (2009)		El Salvador (2008)	Belarus (2006)	Iran (2012)	Mexico (2008)	Romania (2004)	Uruguay (2008)
Brazil (2010)		Jordan (2004)	Belize (2004)	Jamaica (2004)	Mexico (2009)	Romania (2005)	Uruguay (2009)
Brazil (2011)		Jordan (2008)	Belize (2005)	Jamaica (2005)	Mexico (2010)	Romania (2006)	Uruguay (2010)
Bolivia (2008)		Macdonia (2006)	Belize (2006)	Jamaica (2006)	Mexico (2011)	Romania (2007)	Uzbekistan (2004)
Ecuador (2008)		Macedonia (2008)	Brazil (2007)	Jamaica (2007)	Mongolia (2007)	Sechelles (2004)	Uzbekistan (2006)
Eritrea (2008)		Nicaragua (2006)	Brazil (2008)	Jamaica (2008)	Myanmar (2004)	Sechelles (2005)	Venezuela (2004)
Ethiopia (2008)		Nicaragua (2009)	Brazil (2009)	Lebanon (2004)	Nigeria (2006)	Sechelles (2006)	Venezuela (2005)
Fiji (2010)		Nicaragua (2009)	Brazil (2010)	Lebanon (2005)	Panama (2004)	Sechelles (2007)	Venezuela (2006)
Gabon (2008)		Pakistan (2009)	Brazil (2011)	Lebanon (2006)	Panama (2005)	Sechelles (2008)	Venezuela (2007)
Maldives (2008)		Romania (2006)	Brazil (2012)	Lebanon (2007)	Panama (2006)	Sechelles (2009)	Venezuela (2008)
Sri Lanka (2009)		Turkey (2006)	Chile (2004)	Lebanon (2008)	Panama (2007)	St. Kitts (2004)	Venezuela (2009)
St. Kitts (2006)		Uruguay (2005)	Chile (2005)	Lebanon (2009)	Panama (2008)	St. Vincent (2004)	Venezuela (2010)
Sudan (2010)			Chile (2006)	Lebanon (2010)			
Uzbekistan (2010)							
Zimbabwe (2006)							

Table 3.2: Countries whose largest loan also was the most expensive (as defined by the grant element) in comparison to the counterfactual borrowing options.

In sum, the hypothesis that countries always choose the cheapest creditor can confidently be rejected. When deciding among competing loan offers countries obviously do not only take economic considerations into account: Countries do not always choose the cheapest loan offer. It is therefore reasonable to expect that political considerations trump economic factors when governments decide between competing loan offers.

3.6 Borrowing decisions and the type of project

Besides the cost of the project, the type of project to be financed might affect the choice of creditor. If a country has a particular economic profile and subsequent supply bottlenecks in relation to their endowments, its government would want to borrow from a particular creditor. For example, when a country would want to bolster its budget, it might turn to private creditors whereas it might solicit loans from the Chinese if it intended to finance an infrastructure project.

I argue that this rationale is not applicable, for two reasons. First, only a fraction of the sovereign loans a government receives from external creditors are tied to a particular project. In addition, governments also obtain budget loans. In other words, loans are not generally earmarked for particular projects.

I also argue that even for the fraction of loans that are tied to a particular project, governments typically receive loan offers from several creditors. Faced with the requirement to choose among loan offers, I argue that politics affects the decision-making in the manner suggested by my theory.

However, even more important for the question of whether the type of project determines the choice of creditor is the issue of fungibility. Epstein and Gang (2009, p.17) remark that “the empirical literature has not been able to provide a robust measure of the degree of aid fungibility. Nevertheless for many years, at least since the introduction of structural adjustment aid in the 1980s, aid policy has assumed near 100% fungibility.” The heart of the problem is appropriately summarized by Dollar and Pritchett (1998):

One way to ensure additionality is for donors to finance only items or projects that governments are not financing. Common sense tells us, however, that this reasoning is flawed. It would mean that donors finance only what countries and governments do not want to do. And government would have little or no commitment to implementing or, much less, maintaining projects once donors depart. Some governments (purposely or by default) have given donors free rein to do what ever they feel like. Money for such projects would almost certainly be ‘additional,’ but with equal certainty the projects themselves would be pointless, except in those rare cases that the project itself creates commitment. Far better that both recipients and donors be strongly committed to the sustainability of projects. But this is precisely when money will be fungible. (Dollar and Pritchett, 1998, p.79)

In a review of the empirical literature Jones (2005) confirms that external resources provided to sovereign governments are generally fungible. Several econometric studies provide robust evidence for the phenomenon that governments reduce their own budgets for particular sectors if they received aid tied to projects in the respective sector (Pettersson, 2007; Feyzioglu, Swaroop and Zhu, 1998). Analyses examining the development of individual countries’ budgets over time came to similar conclusions. In the case of Uganda, Dollar (2006) states “that it is possible that all of the successful donor-financed projects in Uganda would have been undertaken by the private sector or by the government itself if aid resources had not been available.” Similarly, Pack and Pack (1993, p.258) conclude that their findings with respect to “the fungibility of foreign aid in the Dominican Republic are consistent with the most negative views on this question contained in the literature.” Considering this evidence for the fungibility of aid, scholars have concluded that “targeting assistance to specific projects is essentially a futile exercise” (Svensson, 2000, p.72).

There appears to be no difference between loans and aid as – at least with respect to the issue of fungibility – both are merely transfers of external resources to a sovereign

recipient. The issue would be different if one were to consider loans to individual companies for a particular project. In this case, the recipient company would be a comparatively small entity with a typically narrow focus. The re-allocation of internal resources towards alternative operations is unlikely and in many cases impossible. However, a sovereign borrower running a country would have many opportunities for re-allocation. The empirical literature confirms this view. For example, with respect to the IMF (Dreher, 2009, p.246) states that fungibility of money implies that the IMF's control over its loans is limited. Rodrik (1995, p.26) points out that since external resources are fungible, governments might use IMF loans to repay private loans without the IMF being able to veto such reallocation of resources. It therefore appears that even with loans, the dated quote by Finch (1983, p. 77) still holds: "The Fund has to accept that the authorities of a country are the sole judges of its social and political priorities."

In conclusion, "donors should take it for granted that their financing is fungible because that is reality" (Dollar and Pritchett, 1998, p.91). Therefore, it is reasonable to assume that the type of project financed does not necessarily pre-determine the choice of creditor. In fact, even without fungibility of external resources and ignoring budget loans, recipient governments would still be faced with a choice among competing loan offers for particular projects.

3.7 Distributional consequences and actors' preferences

In Section 3.5, I have shown that recipient governments do not choose creditors based on the cost of the loans. Section 3.6 adds that the type of project to be financed does not predetermine the choice of creditor either. What criteria, then, do governments use in order to choose among competing loan offers?

As suggested in Chapter 2 I argue that the government's decision between loan offers is determined by the preferences of domestic interest groups relevant for the maintenance of incumbency. More specifically, Section 2.3 combines the actors' general interests with the

characteristics of the four borrowing options – multilateral creditors, bilateral loans from DAC and BRIC countries, or private sources. I analyze the distributional consequences that each type of loan would have on the respective domestic actor in order to derive the actors’ preferences with respect to these four types of creditors (see Table 2.1).

The purpose of this section is to provide qualitative evidence for the assumption that Finance, Industry and Labor have preferences across their government’s borrowing options, and, in fact, that these preferences differ across interest groups. I will therefore draw on the interviews I conducted in Ecuador, Peru and Colombia with representatives from Finance, Industry and Labor.

As to the observable implications from my theory, I expect that Finance exhibits a strong preference against BRIC loans but in favor of multilateral and DAC creditors. Industry, in turn, is assumed to be partial to BRIC loans and private creditors. Labor is expected to have strong preference for BRIC and DAC loans, while it would refuse multilateral loans. The final observable implication would be that the divergent preferences of Finance, Industry and Labor across loan offers will be constant across the three countries.

3.7.1 Loan preferences of Finance

According to my theory, domestic Finance would strongly favor traditional lenders – the IMF, DAC creditors, and private lenders – over BRICs. My interviews with representatives of the financial sectors in Ecuador, Peru and Colombia confirmed these expectations.

BRICs When asking about DACs versus BRICs, Finance’s preferences were distinctly in favor of the former. For example, a high-level executive of an Ecuadorian investment bank stated that “[the Chinese] grab you by the balls and take advantage of you” (Checa, 2011). Other financial actors agree that these loans are the first step to further withdrawal of western actors. A former financial manager of an Ecuadorian bank voiced that he is “angry” because of the kinds of conditions that the Chinese impose. In his view, the Chinese

are taking advantage of the situation where the government exhibits a strong preference for their loans over western creditors (Rodas Espinel, 2011). Knowing this, it appears to the former finance minister as if “[the Chinese] can demand whatever they want” (Salgado, 2011). “After all,” added the director of a conservative think tank, “where else can you get 7% interest rate at no risk?” (Albornoz, 2011).

Chinese loans also are viewed as a way to secure investment concessions and contracts for public works. For example, managers have the impression that these loans were the reason subsequent oil concessions and contracts for hydropower projects were given to Chinese companies (Checa, 2011; Salgado, 2011; Albornoz, 2011). From their perspective, there is reason to worry that these loans will not benefit Ecuador. One interviewee told me that he visited Chinese projects in Africa around 2005, “and was appalled.” He initially had been given the impression that the Chinese were making a positive impact on the local economy, but that was not the case in his experience (Steiner, 2011).

The negative attitudes by Finance towards emerging creditors also manifests itself in the behavior of these actors towards the Chinese. For example, the Colombian financial sector has been unwilling to work with Chinese actors. If the Chinese want to open an account, there is only one commercial bank in Colombia that is willing to work with them. According to a representative of this bank, the underlying reasons are illustrated by the experiences of Huawei, a Chinese electronics and communications giant that wanted to establish a presence in Colombia (Guarin, 2011). Huawei arrived in 2001 with exactly two representatives. However, they were unable to open an account in Colombia as not a single bank wanted to work with them – not even the Colombian branch of Citibank, despite their strong representation in China. For example, the Chinese used their apartment as their office, which is frowned upon by Colombian actors in the finance sector as it is perceived as unprofessional. Instead, the Colombians deem the “Americans [as] the maximum level of everything” in terms of their living style, professional work environment, and clothing. In contrast, to the Colombians, the Chinese representatives were dressed plainly. One

anonymous interviewee noted that “they are peasants [...] and the Colombians think that the Chinese stink like onions.” In addition, the Chinese are said to print legal documents in order to then scribble annotations on everything. Colombians despise this practice as they prefer clean and unaltered originals. In contrast to the majority of Colombian banks, my contact who was willing to work with the Chinese did develop trust, which subsequently turned into a business relationship. Three years later, representatives of the Colombian Citibank asked my contact “How can you support these Chinese, these dirty people?” In addition, the financial elite typically send their children to the best and most expensive private schools in Bogota. However, my contact’s children were sent to travel in China to have new experiences, to which the other parents exclaimed “Are you crazy to send your children to China?”

I realize that this anecdote contains many instances of prejudice that appear too cliché to be true. However, the sentiment of the narrative appears to be representative as Chinese private actors report having received such behavior. For example, a representative of the Industrial and Commercial Bank of China (ICBC) told me of the difficulties establishing offices and business relationships in Colombia and Ecuador, while they have been able – after considerable effort – to open a small office in Peru. The careful wording of this representative referred to the argument that the Chinese entering the Peruvian market would mean more competition, to which the interviewee responded that “the other foreign companies are allowed to enter Peru as well, so why shouldn’t the Chinese? Further, the other companies are welcomed in China as well, thus it is only fair that the Chinese go to Peru as well. Also, the pie is so big that you have to be able to profit somehow. If you don’t profit from doing business with the Chinese, then this is your problem, not mine” (Xiaohe, 2011).

DACs While Finance exhibits a strong preference against BRIC loans, their positive attitude towards DAC creditors is wholehearted. “Prefiero malo conoide que bueno por conocer [I prefer the evil that I know over the unknown]” is a saying that I encountered

frequently during my interviews with financial actors. An Ecuadorian business representative stated that “I love the Chinese, but I fear them because I saw what they are capable of – see Tibet. It is scary if you are in the hands of China. If I would have to choose hands, I would probably choose the US because I know them” (Rodas, 2011).

These sentiments are present in the financial sector of Colombia and Peru as well. A Colombian business lawyer states that “we simply don’t know about China” (Ibarra, Moreno Henao and Mendoza de Galofre, 2011), while a Colombian professor of international business adds that “We see a big monster – we don’t know what they [the Chinese] want” (Garcia, 2011). A Colombian interviewee that requested to remain anonymous stated that “With the US, Colombia isn’t quite sure what their political agenda is. However, whatever it is, we can live with it.” Similarly, in Peru, an investment manager told me that “The Chinese are not a good business to have. [...] We are going to miss the Americans. They may be as corrupt as anyone else, but their values of how to do business are not shared by the Chinese” (Anonymous, 2011*f*).

IFIs The representatives of Finance also confirmed my theoretical expectations with respect to how they view multilateral lenders. An Ecuadorian business representative stated that “it is better to sign with the IMF even if you disagree instead of shouting ‘Imperialism’. Having more unemployment in your country because of your 5 minutes of pride is not worth it” (Rodas, 2011). A former director of Colombia’s leading economic think tank, who is also former Finance Minister, noted that in his experience Chinese loans are typically obscure and associated with a lot of corruption. He would therefore prefer IMF loans over Chinese loans, despite the conditions attached to the former (Perry, 2011). Ecuadorian financial experts agreed, voicing their frustrations with Ecuador paying off its IMF loans early. After all, if a government wants to reduce its debt burden, it should use resources to repay the most expensive loans first in terms of interest rates. Ecuador therefore should have held on to IMF loans as they are characterized by relatively low interest rates (Albornoz, 2011; Oleas M, 2011). Also, an investment banker remarked

that he missed the IMF's conditions that limit the government's room to maneuver as "in Ecuador, companies are kicked out and investors are treated like shit" (Checa, 2011).

Private Creditors Private debt is viewed in a positive light by representatives of Finance. For example, even though Ecuador's GlobalBonds required a higher interest rate than other debt, financial experts condemned the decision to default on these bonds. The representatives I talked with agreed that there was no economic necessity for default, as Ecuador's debt stock was relatively moderate. At the time, the ratio of external debt to GDP was about 30% and the annual debt service obligations amounted to about 1.5% of GDP which is generally considered to be acceptable. One representative remarked, "from a financial point of view there was no reason to default. This was only done to satisfy an ideological dream. They [the Ecuadorian government] defaulted because they believe that debt is something evil that keeps developing countries underdeveloped" (Albornoz, 2011).

In sum, my interviews with representatives of Finance confirm the theoretical expectations. Finance exhibits a strong preference for the IMF, DAC lenders and private creditors, while they forcefully condemn BRIC loans.

3.7.2 Industry's preferences regarding creditors

The analytical considerations in Section 2.3 suggest that Industry prefers BRIC loans and private creditors over DAC loans, and that it is undecided with respect to multilateral loans. The evidence from interviews with Industry representatives confirm these observable implications.

BRICs Because the Ecuadorian government has already signed loan agreements with the Chinese, I asked each interviewee from the Ecuadorian industrial sector if they dislike Chinese loans. After all, these loans are often tied to the condition that the resources lent must be spent on the services of big Chinese companies which puts Ecuadorian companies at a disadvantage. For example, Ecuador borrowed \$1.7 billion from China to construct

Coca Codo-Sinclair hydropower dam. The loan was tied to the condition that a Chinese company would be contracted to construct the dam. In fact, Sinohydro, a Chinese state owned company, did get the contract for the construction of the dam.

However, virtually all interviewees disagreed with this leading question. Their argument is that Ecuadorian firms do not lose out due to this practice, because there are no Ecuadorian firms that have the capacity for such massive projects. In fact, the smaller Ecuadorian firms are glad that the big Chinese companies come in, as they expect business through subcontracting that would not have been available otherwise (Checa, 2011; Perez, 2011; Jácome Estrella, 2011; Albornoz, 2011). If there is any crowding out, then it is the interests of western companies and investors that are displaced by the Chinese (Paredes, 2011). A representative of an Ecuadorian bank that usually finances investment undertakings by domestic industry stated that companies are actually quite happy with the Chinese. Because of the tied loans, the prices are not ‘right’ (i.e. set by market standards) as there is no competitive bidding process in the first place. Thus, “Ecuadorian subcontracters are actually paid quite generously by the Chinese” (Anonymous, 2011*c*).

Naturally, the situation in Colombia differs from the one in Ecuador as there have not yet been any Chinese loans to the government. However, speaking with Industry representatives in Colombia, clearly indicated that domestic Industry in this country is also in favor of increased relations with China. For example, the largest business association in Colombia, Asociación Nacional de Empresarios de Colombia (ANDI) has created a new office within their organization with the sole purpose of intensifying relations with China (Salamanca, 2011). Besides attracting Chinese loans and investment, they also work towards more immediate goals, such as streamlining the process by which Chinese businesspersons could obtain a Colombian work visa.

Moreover, Colombian businesses themselves are not afraid to be ‘invaded’ by the Chinese. Instead, they want foreign technology and knowledge as they “recognize that we [domestic industry] can learn a lot from foreigners. I wouldn’t be concerned at all [about

the Chinese]” (Peña, 2011). I once was even openly laughed at when asking whether there would be any resistance against Chinese investments that might follow Chinese loans – this is apparently perceived to be a ridiculous thought to begin with (Ríncon, 2011). In addition, one businessman told me that he is on the board of an agrobusiness company, whose equity is currently bought by a Chinese investor “and nobody cares” (Steiner, 2011). The Chinese confirm this perspective. A representative of the Chinese embassy to Colombia confirmed that they “haven’t received any complaints from local businesses. The Colombians have a welcoming attitude” (Quan, 2011).

Nevertheless, my fieldwork did not necessarily reveal a perfectly clear picture. The messiness of the reality I confronted during my time in the field revealed that not every company is happy about increased Chinese business activities.

For example, the majority of the Peruvian Industry representatives appeared to be in favor of intensified relations with China. However, individual companies that fear losing from such a development have been reported to organize singular actions. One example is the textile industry in Peru. While there is no direct competition of Peruvian firms with Chinese investments in general, the government recently banned the import of Indian yarn – even though Peru needs to import cotton as it does not produce it sufficiently. However “Somebody with interests” must have taken political action (Kuczynski, 2011).

The situation in Colombia might differ in the sense that there exists a stock of entrepreneurs associated with comparatively strong local companies. Consequently, there is a sense of how to face competition and therefore “Colombians are not sitting there and waiting for FDI to happen” (Thiell, 2011). Instead, individual companies are taking political action to defend their position. For example, the native car manufacturer felt threatened by the potential of a Korean manufacturer coming to Colombia. Thus, one commentator recalls an issue of the main Colombian newspaper ‘El Tiempo’ that – in the same day – featured a full-page advertisement for an investment treaty with Korea as well as another full page ad arguing against such a treaty (Garcia, 2011).

In spite of these situations, Industry generally appears to be in favor of intensified financial and business relations with China. While “it is very hard to get a win-win situation. There are always losers” (Herrera, 2011), it appears that only a minority of industries opposes the Chinese. One lawyer even suggested that “The smaller an enterprise, the more resistance there is against the Chinese, while larger companies are ok with [the Chinese coming to Colombia]” (Ibarra, Moreno Henao and Mendoza de Galofre, 2011).

DACs I hypothesized that Industry has negative preferences with regard to DAC loans. As these loans are likely to go hand-in-hand with demands for ‘good governance’ conditions, DAC loans might reward countries that lower barriers to investment and trade with western companies. This perspective was confirmed in interviews as the challenge from Chinese firms was viewed as minor in comparison to the competition imposed by established western multinational companies. For example, one business representative complained that import taxes are not used sufficiently to protect certain industries (Rodas, 2011). Others agreed that Ecuador renouncing the investment treaties with western governments that “overprotected foreign investors” was the right action to take. After all, allowing these companies to sue the Ecuadorian government or firms in foreign courts is improper (Piedra Vivar, 2011). In contrast, Chinese companies were cited as being in favor of fewer legal restrictions.

Conventional wisdom also suggests that Chinese companies are less welcomed as they are assumed to bring their own labor. This would reduce the spillover of business conducted by Chinese companies into the local economy. However, the opinion of Industry representatives did not view Chinese firms as different from western companies in this regard. A Colombian business representative stated that in his opinion, “if Siemens [a western company] would open a plant in Colombia, they would bring their own engineers and consequently there would be no spillovers. In contrast, if China opens a plant, they use it as a production hub for the region. Simply because of their language they are required to hire more local staff, and thus there will be spillovers ” (Gaviria ’Angel, 2011).

Lastly, Industry was quite outspoken against good governance requirements that would prohibit their government from implementing industrial policy. For example, Colombian Industry representatives support the government’s program aimed at boosting productivity in specific sectors (Salamanca, 2011; Duarte, 2011). President Uribe instigated the “Productive Transformation Program,” and most Industry representatives are glad that President Santos is continuing this program, albeit under a different name (‘Locomotivas’). In sum, my impression is that Industry would disapprove of DAC loans with conditions that would undermine the government’s ability to pursue an industrial policy⁸ .

IFIs and private creditors Lastly, the theoretical framework suggests that Industry is undecided with respect to its preference for or against multilateral loans. Admittedly, I obtained little evidence that can support – or disprove – this analytical claim. The interviewees seem to believe that multilateral loans are not significantly relevant for them. Some mentioned that IMF conditions might improve the business climate in their countries, while others thought that austerity measures would lead to a reduction in investments and thus loss of income on the part of Industry. Nevertheless, these opinions were not defended vigorously. I obtained the same impression with respect to private creditors.

In sum, the interviews provide powerful evidence for the main analytical predictions that Industry views BRIC loans favorably and DAC creditors are seen with a more critical attitude.

3.7.3 Borrowing preferences of Labor

Labor represents all domestic actors that own neither mobile or immobile capital, unlike Finance or Industry. Instead, Labor subsumes all citizens who have to sell their labor on the market in order to earn a livelihood. Combining these characteristics with the information on the various borrowing options, my theory suggests that Labor is in favor

⁸ For further discussion on the preferences of domestic industry with respect to its government’s ability to implement industrial policy see Chang (2002)

of BRIC loans for their potential to create employment opportunities, and DAC loans for their focus on educational and social expenditure. In contrast, Labor would disapprove of multilateral loans due to the austerity measures attached. Similarly, private creditors would be viewed critically. The interviews with Labor representatives confirmed these theoretical expectations.

BRICs BRIC loans are generally viewed in a positive light. Most civil society and labor representatives knew of the characteristics of Chinese loans, namely high interest rates and the condition to spend the money on Chinese goods and services. Nevertheless, the same representatives were not opposed to big Chinese companies obtaining the contracts for large infrastructure projects that were financed with Chinese loans. After all, these do translate into employment opportunities, which is the main priority for Labor representatives (Cooper, 2011; Posada, 2011; Steiner, 2011). In fact, as other creditors might not be interested in financing huge hydroelectric dams due to the immense start up capital required, Chinese loans provide added benefits to the recipient countries.

Several Labor representatives further mentioned that they like the fact that the government is now more independent of the multilateral creditors (Mancero de Viterio, 2011; Jácome Estrella, 2011). This stands in stark contrast to the opinion of Finance, where a banker voiced his outrage concerning the fact that the general population does not view the Chinese conditions critically: “I am angry because of the kinds of conditions that the Chinese impose, and that the government is willing to accept. I am angry that my people don’t realize this” (Rodas Espinel, 2011). Along these lines, the general population is also in favor of intensifying relations with China in other areas, such as trade. For example, a former prime minister of Peru noted that there was general support for establishing a Free Trade Agreement with China. While the local textile industry lamented the expected negative effect on the domestic clothing production, the population was in favor of lower prices – which propelled the government to sign the FTA agreement (Kuczynski, 2011).

IFIs Labor exhibits strong distaste for multilateral loans. Several interviewees emphasized how the IMF had previously demanded conditions that undermined the productive capacity of their country, which in turn made repayment of debt even more difficult (Mancero de Viterio, 2011). A Jubilee activist recalled how the IMF policies in response to the Ecuadorian debt crisis in 1999 resulted in the bankruptcy of 3 million businesses, much capital flight, and the emigration of about 20% of the productive population. It was therefore no surprise that social movements sprung up against multilateral creditors, demanding a re-ordering of priorities (Salgado, 2011). The government subsequently exploited these sentiments for electoral gains. Correa wanted to secure the loyalty of the large social movement that is critical of multilateral creditors. He therefore organized a Commission to Audit the Entirety of Public Debt [Comisión para la Auditoria Integral del Credito Publico] “in order to secure an ideological mandate for governance from this movement” (Kaiser, 2012).

Private Creditors Similarly, Labor’s opinion of private creditors is negative. Interviewees mentioned how private creditors have contributed to Ecuador’s economic problems by demanding high interest rates (Salgado, 2011). In addition, bonds in particular are viewed critically, as Labor assumes that domestic elites were able to purchase these bonds as well – which constitutes a redistribution of taxes from the general population to the elites who earn interest from these bonds.

3.7.4 The variation of borrowing preferences

In conclusion, the interviews I conducted with representatives of Finance, Industry and Labor largely confirm the empirical implications of my theory. I present powerful evidence that Finance has strong negative preferences with respect to Chinese loans. Considering the negative distributional consequences they can expect from these loans, it is not surprising that the Finance representatives offered strong (and starkly worded) statements. They

strongly prefer traditional creditors over emerging lenders. In contrast, interviews with Industry revealed that they are in favor of Chinese loans as they expect opportunities for business via subcontracting. Lastly, Labor exhibits strong opinions with respect to both Chinese and multilateral loans. While the former are viewed with extreme optimism, the negative effects of past IMF loans manifest themselves in a strong opposition towards multilateral creditors.

I also show that the preferences of the respective actors are constant across countries. Given the constant preferences of Labor, Industry and Finance across the different countries, why do some governments accept BRIC loan offers while others reject them? My theory suggests that the role of incumbent politicians is key in the process of preference aggregation and policy implementation. I hypothesize that politicians observe the structural conditions of the political economy in order to deduce whose interests are congruent. As politicians have the incentive to maximize electoral support, they will implement policies that satisfy the demands of the minimum winning coalition. I present evidence for how this process can play out in the following chapters.

3.8 Summary

The evidence presented in this chapter provides strong *prima facie* support for the theory proposed in Chapter 2. First, I show that a demand-side theory is entirely appropriate to explain variation in borrowing patterns as the supply of loans can be taken as constant. In addition, examining the processes of borrowing decisions in Ecuador, Peru and Colombia reveals that governments typically have the option to choose between different creditors. This implies that an approach explaining a government's decision *between* creditors is more appropriate than examining the conditions under which a government would borrow from one single creditor. Evidence is also provided in support of the claim that a government's decision *for* one creditor is simultaneously a decision *against* another.

Having made a *prima facie* case that governments need to choose among loan offers,

this chapter examined several possible criteria that might be utilized in this process. It appears, however, that neither the cost of loans nor the types of projects matter for the choice of creditor. Instead, I show that the preferences of Finance, Industry and Labor vary across the four types of creditors in accordance with the theoretical expectations.

In sum, therefore, there appears to be strong support for the fundamental assumptions on which my theory rests. However, to show that the theory's assumptions are consistent with empirical observations is only the first step. In the following chapters, I therefore make the next step of the analysis by examining the theory's abilities to explain the outcome of the phenomenon of interest. In other words, I will test if my theoretical framework does indeed explain the variation in borrowing patterns observed in the empirical reality.

Chapter 4

Estimating Coalitions – A Measurement Model

4.1 Informal coalitions

In Chapter 2, I presented a theory that explains how the interests of three distinct types of informal coalitions vary across the four types of creditors available to governments. Evidence that supports the basic assumptions of my theory were presented in Chapter 3. I am now in a position to examine whether the borrowing decisions of governments in all developing countries follow my theoretical predictions. For this purpose, I will conduct extensive statistical analyses of 129 developing countries to test whether the type of coalition present in a particular country explains the borrowing decisions made by its government. The quantitative results will be presented in chapters 4 and 5. I complement the statistical analysis with qualitative evidence from my fieldwork in South America. The findings for Ecuador, Colombia and Peru will be presented in Chapter 6.

My theory suggests that developing countries are dominated by one of three types of informal coalitions. A Corporatist coalition is present if Labor and Industry are dominating the political arena. If the interests of Finance and Industry are aligned, a Capital coalition

is present. Lastly, a coalition between Labor and Finance is termed Consumer coalition. In order to test whether informal domestic interest group coalitions explain borrowing decisions I first need a measure that indicates the type of coalition.

The main challenge for creating such a measure is the fact that these coalitions are informal and therefore not directly observable. For instance, there are no formal arrangements between Finance and Industry to lobby the government regarding their preferred choice of creditor. Yet, my interviews with politicians clearly indicated that they understood whose interests were aligned. In Chapter 2, I therefore argued that politicians observe the conditions of the domestic economy in order to derive whose interests are aligned and consequently can be accommodated simultaneously. In other words, politicians aggregate societal interests as they have an incentive to think in terms of informal coalitions in order to maximize their chances for reelection.

In this chapter, I implement this conceptual framework. I propose a quantitative analysis that models the process by which politicians observe the structural conditions of the domestic political economy to make inferences about the relative positions of Labor, Industry and Finance. I estimate the latent probability with which the interests of Labor are aligned with those of Industry versus Finance. I then repeat this exercise for Industry and Finance. Once the positions of Labor, Industry and Finance are known, two of these interests must overlap. Politicians then have the incentive to assume an informal coalition between these two actors in order to implement a policy that satisfies the demands of both actors simultaneously.

The remainder of this chapter is organized as follows: I will first examine the existing scholarship on understanding coalitional arrangements between domestic actors. Section 4.3 introduces a theory of informal coalition formation that addresses the gaps in the existing scholarship. Section 4.4 implements this theory using factor analyses to estimate the latent indicators for each actor. As the use of factor analysis is appropriate but not ideal, Section 4.5 presents the results of a latent profile analysis. This allows me to create

a measure that indicates the type of coalition present in a particular country in each year.

4.2 Identifying coalitions

4.2.1 Empirical approaches

Identifying informal coalitions is a challenging task. One way of empirically identifying coalitions is to find measures of an actor's strength and include interaction terms of these variables in the regressions. If the interaction terms have a statistically significant effect on the dependent variable while its component terms do not, it could be argued that a coalition is present.

However, this approach makes the implicit assumption that the strongest actors will form an alliance. This might not necessarily be the case as it is entirely reasonable to assume that two smaller actors will cooperate to overpower the strongest actor. In addition, this approach gives no consideration to the interests of the individual actors. It assumes that actors cooperate to gain power, but not in order to implement policies that they jointly prefer. Further, this approach requires indicators that adequately measure the strength of the actors. For example, in the case of Labor, one could use indicators such as the size of the Labor sector or union density. However, these indicators are likely to be characterized by missing data or questionable empirical validity, in particular when considering developing countries. Lastly, this approach assumes that economic size can be equated with the political power of the respective agents. This is questionable as Labor's power might be primarily derived from its numbers and subsequently its importance in elections as it provides the largest block of potential votes. In contrast, Finance is numerically small and is likely to influence politicians by other means, such as campaign contributions. While initially appealing, the approach to use interactions is not ideal.

Alternatively, scholars have suggested analyzing the revealed interests of actors. In this approach, the presence of coalitions would be deduced from the observed behavior of the

actors. For example, if one were to observe lobbying behavior of Finance, Industry and Labor, one could identify the actors who are lobbying for the same cause. The advantage of this approach lies in the fact that it does not require strong assumptions as it is solely based on observed behavior.

However, Bearce (2003) notes that we can observe actors revealing their interests only under certain circumstances. For example, there is little lobby activity when politicians appear to be acting in the interests of the dominant coalition already. Conventional wisdom therefore exaggerates lobby activities, as it ignores that lobbying is only necessary when governments diverge from the preferred policy. In addition to the need to lobby, the interest groups only engage in lobbying if they perceive the chances of lobbying as likely to be successful. In sum, if interest groups do not have the incentive to lobby (because their preferred policy is already being implemented) and/or do not have the capacity to affect current policy even if they disagree with it, we would not observe any lobby activities. The attempt to induce interests from observed behavior also risks confounding interests with their effects. As argued by Frieden (1999), interests must be distinguished from the strategic setting. Instead, interests should be specified through deduction based on prior theory.

In short, relying on observable behavior by actors and deducing informal coalitions from it is likely to result in biased estimates of the type of coalition present.

4.2.2 Conceptualizing coalitions

A natural starting point for conceptualizing which actors will form a coalition is the spatial voting model. The distance between actors' ideal points on a two-dimensional scale has been used to explain a range of phenomena, such as voting decisions (Downs, 1957), party competition (Stokes, 1963), and party activism (Aldrich, 1983). In each of these models, it is hypothesized that the actors will choose the alternative closest to them. With respect to coalition formation, one could design a model where Finance, Labor and Industry are

aligned on a single left-to-right scale. In this case it could be argued that the actors whose positions are closest to each other will form a coalition.

However, this assumes the existence of a single dimension along which Finance, Industry and Labor can be compared. Considering the heterogeneity of the actors' interests (see Section 2.3), one would be hard pressed to make an argument for a single scale that accurately captures each actors' position.

Even if one were to find such a scale it would be challenging to derive all possible coalition combinations. For example, assume that Finance is on the right and Labor is on the left while Industry is somewhere in between. In this situation it is straightforward to show how either a Capital coalition between Finance and Industry or a Corporatist coalition between Industry and Labor is possible, depending on the position of Industry. However, modeling the third combinatoric possibility – a coalition between Finance and Labor, the Consumer coalition – would require Labor and Industry or Industry and Finance 'switching' positions on the unidimensional scale. It is questionable how realistic such an assumption would be.

Considering the challenge of finding a single scale to represent the actors' positions as well as the procedural necessity for actors to switch relative positions, I argue that modeling coalition formation with a spatial model on a single scale is imprudent. Instead, I will propose an alternative spatial model that aggregates the information derived from a separate spatial scale for each actor instead of forcing the comparison of the actors on a single scale.

4.3 A theory of informal coalitions

I begin with the assumption that each politician's main goal is to win or maintain office. Office-seeking politicians have the incentive to cater to multiple constituencies simultaneously in order to maximize the prospect of maintaining incumbency. In such a situation, it is advantageous for politicians' policies to satisfy the interests of multiple societal groups

simultaneously. I therefore argue that politicians carefully observe the conditions of the domestic economy to infer which actors are likely to have similar interests. Once they have analyzed which two of the three domestic actors have congruent interests, politicians have the incentive to implement policies – i.e. borrowing from the jointly preferred creditor – that satisfy the interests of both actors at once.

Politicians therefore observe the overall economic and political environment to determine whether the interests of two actors are congruent. If the majority of Labor is employed in Industry, Labor's interests can be expected to be similar to those of Industry, due to its dependency upon it. For example, Labor would be in favor of increasing investment in order to create employment opportunities which happen to be in the interest of Industry as well. In contrast, under conditions of high inflation, Labor's interests are likely to be congruent with those of Finance. While inflation devalues the capital owned by Finance, it also lowers the real wages of Labor. Depending on the overall state of the economy, the interests of Labor are either congruent with those of Finance or those of Industry.

A similar reasoning applies to the interests of Industry. If the structure of the domestic industry is primarily focused on importing goods from abroad, a healthy domestic consumer base is key. Industry's interests are therefore likely to be congruent with Labor's. In contrast, if Industry is focused instead on selling goods for exports, it will pay close attention to its capacity to export. This will be in part determined by structural factors such as a favorable exchange rate as well as low Labor costs. Historical examples such as the South Korean experience Kay (2002)[see] indicate that to accomplish both Industry allied itself with Finance to the detriment of Labor.

Lastly, the position of Finance with respect to either Labor or Industry also depends on the structure of the economy. For example, if Finance is the primary provider of funding for investment projects by domestic Industry, Finance's interests will be close to those of its primary customers. In contrast, if domestic Finance faces stiff competition from external investors that are willing to provide Industry with the resources needed, Finance's interests

are less likely to be congruent with those of Industry. In such a situation, as evidenced by the fieldwork undertaken in Peru (see Section 6.4), Finance is likely to abandon the intention to fund large infrastructure projects and instead focus on providing basic financial services to the general population.

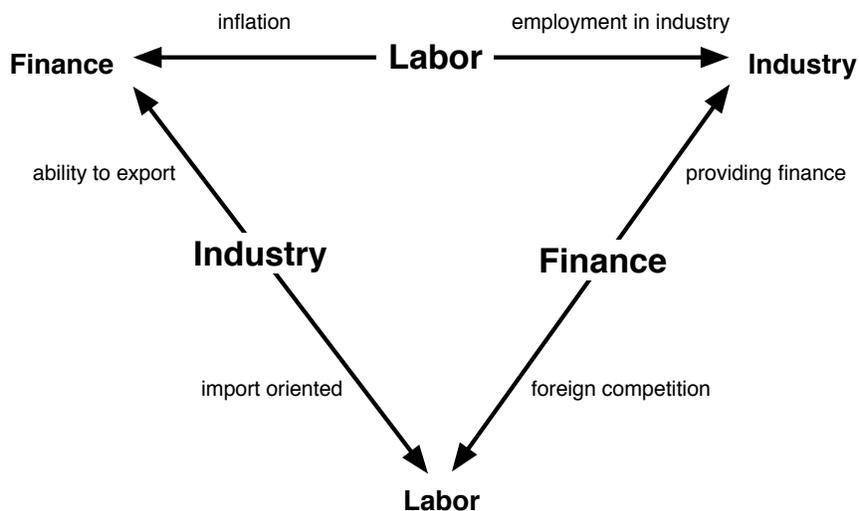


Figure 4.1: Illustration of Decision Model

Figure 4.1 schematically summarizes the considerations developed above. I therefore propose a model with three actors that each have two possible coalition partners and the condition that only two of the three actors form a coalition. This implies that there are 2^3 possible coalitional arrangements between the three actors. However, as is apparent in Table 4.1, these eight possible permutations actually represent only four distinct outcomes as $A+B$ is substantively equivalent to $B+A$. If Industry's interests are congruent with those of Labor (and vice versa), a Corporatist coalition results. A Capital coalition indicates congruent interests of Finance and Industry, while the Consumer coalition is characterized by a affinity between Finance and Labor. Note that two of the eight possible arrangements of actor's relative position result in an intransitive ordering of interests. If Finance wants

Preferred coalition Partner			Congruent Interests	Resulting coalition
<i>of Labor</i>	<i>of Industry</i>	<i>of Finance</i>		
Industry	Labor	Labor	Labor and Industry	Corporatist coalition
Industry	Labor	Industry	Labor and Industry	Corporatist coalition
Industry	Finance	Labor	intransitive	(none)
Industry	Finance	Industry	Industry and Finance	Capital coalition
Finance	Labor	Labor	Labor and Finance	Consumer coalition
Finance	Labor	Industry	intransitive	(none)
Finance	Finance	Labor	Labor and Finance	Consumer coalition
Finance	Finance	Industry	Industry and Finance	Capital coalition

Table 4.1: Possible combinations of congruent interests, and resulting coalitions.

Industry, but Industry wants Labor while Labor, in turn, wants Finance, no stable coalition results.

Conceptualizing each actors' position as the latent probability of overlapping interests has a crucial advantage. It allows for estimating the type of coalition present with conventional statistical methods. Latent variable approaches can combine the relevant *observable* indicators of the domestic political economy into a common indicator measuring the *latent* position of each actor with respect to the other two. I can subsequently combine the information on each actors' position to show which actor's positions are congruent. This way I arrive at estimations of the coalition that is present in a country at a given time. The following sections will present two approaches that implement this theory of informal coalition formation.

4.4 Estimating actor position using factor analysis

4.4.1 The model

Latent concepts are ubiquitous in political science. Abstract ideas such as democracy, political-economic risk or ethnic identity are typically understood as latent concepts for which no direct measure exists. In such situations, researchers typically resort to the use of proxy variables that, within reason, can be expected to capture the concept of interest.

As an alternative to the use of proxies, several methods have been developed to estimate latent concept directly. Each of these latent variable methods attempts to infer the underlying latent variable from observable indicators. Following the classical framework by Lazarsfeld (1950), the four existing approaches to estimating latent concepts can be classified by their respective assumptions about the observable and unobservable variables (see Figure 4.2): Factor analysis is used if the observable indicators are continuous and the latent variable is assumed to be continuous as well. In contrast, latent profile analysis involves a categorical latent variable that is estimated from continuous variables (see Gibson, 1959). Item response theory makes use of categorical observed variables to estimate a continuous underlying latent variable (see ?). Lastly, latent class analysis is used if both the observed variables as well as the assumed latent variable are categorical.

Observed variable type	Assumed latent variable type	Required Analysis
continuous	continuous	Factor Analysis
continuous	categorical	Latent Profile Analysis
categorical	continuous	Item Response Theory
categorical	categorical	Latent Class Analysis

Table 4.2: Lazarsfeld framework of latent variable approaches.

Of these approaches, factor analysis has been used most frequently in political science to estimate latent concepts. In American Politics, researchers have employed factor analysis to estimate the ideal points of US Senators (Clinton, Jackman and Rivers, 2004) or judges serving on the Supreme Court (Martin and Quinn, 2002). In Comparative Politics, Treier

and Jackman (2008) conceptualize Democracy as a latent variable and estimated the latent democracy score of various countries. Hausermann (2011) uses factor analysis to estimate the position of parties, unions and employer organizations with respect to their support or opposition for employment protection policies. To create a measure of asset specificity, Rehm (2010) implements a factor analysis to construct a variable measuring the importance of routine tasks within an occupation.

Following these examples, I conduct a factor analysis to estimate the latent position of each actor with respect to the other two actors. I implement a confirmatory factor analysis, as the theory introduced in Section 4.3 dictates how many factors are to be expected. To estimate the patterns of association between the observed variables in X and the latent X^* , I use a bayesian factor analysis model for mixed ordinal and continuous responses proposed by Quinn (2004). Formally, this model is defined by

$$x_i^* = \mathbf{\Lambda}\phi_i + \epsilon_i \quad (4.1)$$

where x_i^* is the J vector of latent responses specific to observation i , $\mathbf{\Lambda}$ stands for the $J * K$ matrix of factor loadings, ϕ_i represents the K vector of factor scores specific to observation i , ϵ_i is the J vector of disturbances. The factor scores are assumed to be independent standard normal prior distributions:

$$\phi_i \text{ iid } \mathcal{N}(0, \mathbf{I}) \quad (4.2)$$

To achieve identification, Ψ is assumed to be diagonal:

$$\epsilon_i \text{ iid } \mathcal{N}(0, \mathbf{\Psi}) \quad (4.3)$$

To fit the model, Quinn re-writes it in terms of X^* and subsequently treats X^* as latent data in order to work with the following posterior density:

$$\begin{aligned}
p(\mathbf{X}^*, \gamma, \mathbf{\Lambda}, \phi, \mathbf{\Psi} | \mathbf{X}) &\propto p(\mathbf{X} | \mathbf{X}^*, \gamma) p(\mathbf{X}^* | \mathbf{\Lambda}, \phi, \mathbf{\Psi}) p(\gamma) p(\mathbf{\Lambda}) p(\mathbf{\Phi}) p(\mathbf{\Psi}) \\
&\propto \left\{ \prod_{i=1}^N \prod_{j=1}^J \left\{ \mathbb{I}(x_{ij} = x_{ij}^*) \mathbb{I}(X_j \text{ continuous}) \right. \right. \\
&\quad \left. \left. + \sum_{c=1}^{C_j} \mathbb{I}(x_{ij} = c) \mathbb{I}(x_{ij}^* \in (\gamma_{j(c-1)}, \gamma_{jc})) \mathbb{I}(X_j \text{ ordinal}) \right\} \right. \\
&\quad \left. \times p_{\mathcal{N}}(\mathbf{x}_i^* | \mathbf{\Lambda} \phi_i, \mathbf{\Psi}) \right\} p(\mathbf{\Lambda}) p(\mathbf{\Phi}) p(\mathbf{\Psi})
\end{aligned} \tag{4.4}$$

where $\mathbb{I}(a)$ is the indicator function, which is equal to 1 if a is true and 0 otherwise. $p_{\mathcal{N}}(z | \mu, \Sigma)$ is a multivariate normal density with mean μ and variance-covariance matrix Σ evaluated at z , and $p(\mathbf{\Lambda})$, $p(\mathbf{\Phi})$, and $p(\mathbf{\Psi})$ are the prior densities for $\mathbf{\Lambda}$, $\mathbf{\Phi}$, and $\mathbf{\Psi}$, respectively. The prior for γ drops because it is constant for all values of γ . It is then possible to derive the full conditional distributions for the model parameters from this posterior density. This allows for a Markov chain Monte Carlo (MCMC) algorithm to be used for model fitting which samples from the full conditional distributions of \mathbf{X}^* , $\mathbf{\Lambda}$, $\mathbf{\Phi}$, and $\mathbf{\Psi}$ and uses a Metropolis-Hastings step to sample γ . When applying Quinn's estimator to my data I will run 100,000 iterations while discarding the first 10,000 as burn-in and subsequently storing every 100th scan.

4.4.2 Estimating Labor

In Section 4.3, I argued that Labor's position with respect to Finance and Industry is determined by its concern about inflation and employment. Ideally, I would require variables that are tightly related to the actor's interests. For example, when inferring Labor's interests I would prefer to use data concerning whether wage increases are tied to inflation. If Labor would have insisted on such a precaution when negotiating wage contracts, it would be strong evidence that Labor is highly sensitive to inflation. This would be strong

support for the assumption that Labor would likely have similar interests to Finance. Unfortunately, such data is unavailable and I will therefore resort to the second-best measures.

Specifically, I will combine the information of four variables to estimate the position of Labor with respect to Finance and Industry. First, the employment in industry as a percentage of total employment is used to capture how dependent Labor is on Industry in terms of employment opportunities. I will assume that the higher the percentage of workers employed in Industry, the more likely that Labor's interests are aligned with those of Industry. Further, inflation, as measured by the annual percentage of consumer price increases, is used to represent Labor's concern with respect to inflation. I assume that Labor is sensitive to high inflation as it negatively affects real wages. High inflation will therefore induce Labor's interests to be congruent with those of Finance which is also concerned about inflation due to the nature of its assets. Third, I include gross fixed capital formation in the domestic private sector as a percentage of GDP. This captures the extent of domestic investment within a country. Labor will benefit from such investment as it is likely to create employment opportunities. I therefore assume that higher domestic investment will align Labor's interests with those of Industry. Lastly, I include the net inflows of foreign direct investment as a percentage of GDP. It is assumed to capture the degree to which Labor is dependent on domestic Industry. After all, if foreign resources are used to finance investment in a country, Labor will be less dependent on domestic Industry to undertake such investments. Low FDI should therefore align Labor's interests with those of Industry, and vice versa.

All data are taken from the World Development Indicators (World Bank, 2012). Prior to estimating the bayesian factor analysis with these variables I reverse the polarity of the inflation variable by multiplying each observation with (-1) to harmonize the values of the four variables included with the assumed implications. With this transformation, high values imply Labor's position being closer to Industry, while low values represent a position closer to Finance. I then proceed to estimate a separate factor analysis for each

year between 1990 and 2010.

The results of the factor analysis models are summarized in Table 4.3. The column labeled λ provides information of what can be thought of as the factor loadings or item discrimination parameters for each variable-year. The column ψ_{jj} provides information on the error variances. As can be seen by the standard deviations, the model performs reasonably well.

Year	Inflation				Employment in industry				Domestic investment				FDI			
	λ	SD	ψ_{jj}	SD	λ	SD	ψ_{jj}	SD	λ	SD	ψ_{jj}	SD	λ	SD	ψ_{jj}	SD
1990	0.33	(0.10)	0.90	(0.12)	0.04	(0.10)	1.01	(0.13)	0.68	(0.15)	0.54	(0.20)	0.88	(0.15)	0.25	(0.23)
1991	0.73	(0.10)	0.50	(0.11)	0.10	(0.10)	1.01	(0.13)	0.60	(0.10)	0.66	(0.11)	0.88	(0.11)	0.26	(0.14)
1992	0.39	(0.11)	0.86	(0.12)	0.14	(0.11)	0.99	(0.13)	0.55	(0.13)	0.70	(0.15)	0.87	(0.16)	0.27	(0.23)
1993	-0.28	(0.11)	0.93	(0.13)	-0.17	(0.11)	0.99	(0.13)	-0.34	(0.12)	0.89	(0.14)	-0.90	(0.17)	0.19	(0.24)
1994	-0.03	(0.13)	1.00	(0.13)	-0.09	(0.29)	0.93	(0.20)	-0.16	(0.32)	0.90	(0.19)	-0.40	(0.70)	0.38	(0.36)
1995	-0.40	(0.19)	0.82	(0.23)	-0.26	(0.12)	0.95	(0.13)	-0.29	(0.13)	0.92	(0.13)	-0.81	(0.23)	0.32	(0.31)
1996	-0.31	(0.10)	0.91	(0.12)	-0.25	(0.10)	0.95	(0.12)	-0.43	(0.10)	0.83	(0.12)	-0.92	(0.14)	0.16	(0.19)
1997	-0.39	(0.10)	0.85	(0.12)	-0.16	(0.10)	0.99	(0.13)	-0.43	(0.10)	0.82	(0.12)	-0.93	(0.13)	0.15	(0.19)
1998	-0.36	(0.12)	0.87	(0.13)	-0.19	(0.12)	0.98	(0.13)	-0.45	(0.13)	0.80	(0.15)	-0.84	(0.18)	0.29	(0.26)
1999	-0.35	(0.11)	0.89	(0.13)	-0.24	(0.10)	0.96	(0.12)	-0.44	(0.11)	0.82	(0.13)	-0.90	(0.15)	0.20	(0.22)
2000	-0.38	(0.12)	0.86	(0.13)	-0.19	(0.11)	0.98	(0.13)	-0.43	(0.11)	0.83	(0.12)	-0.88	(0.16)	0.22	(0.23)
2001	-0.70	(0.19)	0.50	(0.26)	-0.31	(0.12)	0.91	(0.13)	-0.35	(0.12)	0.89	(0.12)	-0.54	(0.17)	0.70	(0.21)
2002	-0.42	(0.16)	0.82	(0.17)	-0.24	(0.12)	0.96	(0.13)	-0.36	(0.13)	0.87	(0.13)	-0.75	(0.21)	0.41	(0.30)
2003	-0.08	(0.41)	0.85	(0.25)	-0.03	(0.17)	1.00	(0.13)	-0.06	(0.33)	0.91	(0.20)	-0.11	(0.78)	0.41	(0.37)
2004	0.50	(0.25)	0.71	(0.31)	0.20	(0.12)	0.97	(0.14)	0.20	(0.12)	0.97	(0.13)	0.67	(0.27)	0.51	(0.36)
2005	0.19	(0.62)	0.60	(0.34)	0.08	(0.26)	0.96	(0.15)	0.07	(0.23)	0.96	(0.14)	0.17	(0.51)	0.74	(0.29)
2006	-0.06	(0.29)	0.93	(0.17)	-0.10	(0.41)	0.86	(0.27)	-0.08	(0.31)	0.92	(0.21)	-0.09	(0.64)	0.61	(0.38)
2007	-0.09	(0.29)	0.93	(0.14)	-0.06	(0.21)	0.98	(0.15)	-0.11	(0.34)	0.90	(0.17)	-0.27	(0.79)	0.35	(0.34)
2008	-0.13	(0.41)	0.84	(0.28)	-0.05	(0.17)	1.00	(0.13)	-0.09	(0.27)	0.94	(0.14)	-0.26	(0.76)	0.40	(0.36)
2009	-0.17	(0.37)	0.86	(0.23)	-0.08	(0.19)	0.99	(0.16)	-0.13	(0.30)	0.91	(0.20)	-0.39	(0.65)	0.45	(0.37)
2010	-0.03	(0.21)	0.98	(0.14)	-0.02	(0.14)	1.01	(0.13)	-0.09	(0.44)	0.82	(0.29)	-0.13	(0.78)	0.41	(0.38)

Table 4.3: Factor loadings of factor analysis for Labor.

The substantively significant results are displayed in Figure 4.2, which illustrates the factor scores for Labor in each of the 129 countries in the sample in a particular year. The estimates for subsequent years are not shown for reasons of space, so that the figure stands as an exemplary display of the data created. For each country, the latent degree of Labor's interest congruence with either Finance or Industry are displayed, along with their confidence intervals. Higher values indicate concurrence with the interests of Industry, while lower values indicate more agreement with Finance.

4.4.3 Estimating Industry

I subsequently estimate the bayesian factor analysis for Industry. Following the theoretical considerations in Section 4.3 I use two variables to estimate Industry's position with respect to Finance and Labor. To capture the degree to which Industry caters to Labor, I include the imports of goods and services as a percentage of GDP. The argument is that if imports are high relative to GDP, domestic industry will depend on the general population as consumers. Industry's interests will therefore be aligned with those of Labor as it represents the numerical majority in the population. To capture Industry's propensity to cater to the export market I will include the real effective exchange rate index (2005 = 100). As an appreciation of the exchange rate makes exports uncompetitive, higher values on this index imply that Industry will be less inclined to cater towards the export market.

As was the case with the factor analyses for Labor, I reverse a single variable to harmonize the ordering of the variables with the theoretical conceptions proposed in Section 4.3. In this case, I multiply the values of the import measure with (-1) so that for all variables higher values indicate Industry's interests being more congruent with those of Finance, while lower values represent alignment with Labor. All data is obtained from the World Development Indicators (World Bank, 2012) and a separate model is estimated for each year from 1990 through 2010.

Table 4.4 displays the model results. The column labeled λ displays the factor loadings for the respective variables across years, while the column ψ_{jj} provides information on the error variances.

The substantively interesting results of this model are displayed in Figure 4.3. As with Labor, the figure displays the point estimates of Industry's position relative to Finance and Labor for each country in the sample. Here, higher values indicate concurrence with the interests of Finance, while lower values indicate more agreement with Labor. While the fit of the model itself is acceptable, the resulting point estimates are not extraordinarily

Year	Imports				Real Exchange Rate			
	λ	SD	ψ_{jj}	SD	λ	SD	ψ_{jj}	SD
1990	0.16	(0.59)	0.65	(0.42)	0.23	(0.67)	0.52	(0.43)
1991	-0.02	(0.60)	0.67	(0.42)	0.14	(0.69)	0.52	(0.43)
1992	0.03	(0.59)	0.68	(0.41)	0.06	(0.69)	0.53	(0.43)
1993	0.09	(0.57)	0.69	(0.41)	0.15	(0.69)	0.52	(0.44)
1994	-0.04	(0.63)	0.62	(0.42)	-0.02	(0.69)	0.54	(0.43)
1995	-0.22	(0.61)	0.60	(0.42)	-0.15	(0.67)	0.55	(0.42)
1996	0.03	(0.62)	0.63	(0.42)	0.06	(0.70)	0.53	(0.43)
1997	0.24	(0.56)	0.64	(0.42)	0.26	(0.61)	0.57	(0.43)
1998	-0.03	(0.57)	0.69	(0.40)	-0.05	(0.73)	0.49	(0.43)
1999	0.01	(0.58)	0.69	(0.40)	-0.04	(0.72)	0.50	(0.43)
2000	0.03	(0.60)	0.65	(0.42)	0.10	(0.67)	0.57	(0.43)
2001	0.03	(0.64)	0.61	(0.43)	0.07	(0.64)	0.60	(0.42)
2002	0.00	(0.62)	0.64	(0.43)	0.16	(0.64)	0.58	(0.44)
2003	0.13	(0.63)	0.60	(0.43)	0.18	(0.61)	0.61	(0.42)
2004	0.13	(0.64)	0.59	(0.43)	0.17	(0.61)	0.61	(0.42)
2005	0.03	(0.62)	0.64	(0.42)	0.16	(0.64)	0.58	(0.43)
2006	0.05	(0.57)	0.69	(0.42)	0.10	(0.67)	0.56	(0.44)
2007	-0.04	(0.53)	0.74	(0.38)	0.05	(0.70)	0.53	(0.43)
2008	-0.05	(0.62)	0.63	(0.44)	0.12	(0.64)	0.59	(0.44)
2009	-0.03	(0.52)	0.74	(0.39)	0.11	(0.69)	0.53	(0.44)
2010	0.05	(0.57)	0.69	(0.41)	0.03	(0.69)	0.54	(0.43)

Table 4.4: Factor loadings of factor analysis for Industry.

convincing.¹

4.4.4 Estimating Finance

Lastly, I estimate the factor analysis for Finance. Following Section 4.3, Finance's position between Industry and Labor is determined by the degree to which it is the main provider of financing to domestic industry. To capture this notion, I use the total claims existing on the private sector (measured as annual growth as a percentage of broad money). The more financing provided to domestic industry, the more interest Finance has in Industry's economic wellbeing. The more interwoven Finance's interest is with domestic companies, the more aligned its position will be with that of Industry. Second, I utilize the net inflows of foreign direct investment as a percentage of GDP to capture the amount of foreign competition faced by Finance. Foreign investors can provide the funding necessary

¹ I will address this issue with a superior model in Section 4.5.

for investment projects that otherwise would have been supplied by domestic Finance. I therefore assume that higher FDI is detrimental for domestic Finance. In other words, if FDI is high, it is less likely that Finance's interests are aligned with those of domestic Industry.

All data is obtained from the World Development Indicators (World Bank, 2012). I transform the variable capturing FDI by multiplying it with (-1) to ensure that higher values of all variables imply that Finance's position is more congruent with that of Industry rather than Labor. As before, I estimate a separate factor analysis for each year from 1990 through 2010.

A summary of the model results is displayed in Table 4.5. The column labeled λ provides information of what can be thought of as the factor loadings or item discrimination parameters for each variable-year. The column ψ_{jj} provides information regarding the error variances. As can be seen by the deviations, the model performs well.

Year	Claims on private sector				FDI			
	λ	SD	ψ_{jj}	SD	λ	SD	ψ_{jj}	SD
1990	-0.75	(0.24)	0.40	(0.34)	-0.71	(0.24)	0.46	(0.34)
1991	-0.86	(0.15)	0.25	(0.23)	-0.83	(0.15)	0.30	(0.23)
1992	-0.75	(0.25)	0.39	(0.35)	-0.68	(0.24)	0.50	(0.35)
1993	0.18	(0.64)	0.57	(0.39)	0.20	(0.69)	0.51	(0.41)
1994	-0.72	(0.26)	0.42	(0.37)	-0.67	(0.26)	0.50	(0.36)
1995	-0.78	(0.22)	0.36	(0.32)	-0.74	(0.22)	0.43	(0.32)
1996	-0.77	(0.24)	0.37	(0.34)	-0.68	(0.24)	0.51	(0.33)
1997	-0.75	(0.24)	0.40	(0.34)	-0.70	(0.24)	0.48	(0.34)
1998	-0.73	(0.27)	0.41	(0.37)	-0.65	(0.26)	0.53	(0.36)
1999	-0.72	(0.25)	0.43	(0.36)	-0.68	(0.25)	0.49	(0.35)
2000	-0.72	(0.25)	0.43	(0.36)	-0.68	(0.25)	0.50	(0.34)
2001	-0.70	(0.26)	0.45	(0.36)	-0.70	(0.26)	0.47	(0.36)
2002	-0.66	(0.31)	0.48	(0.40)	-0.58	(0.30)	0.60	(0.39)
2003	-0.06	(0.69)	0.54	(0.43)	-0.11	(0.61)	0.64	(0.42)
2004	-0.21	(0.66)	0.53	(0.42)	-0.21	(0.62)	0.60	(0.41)
2005	-0.33	(0.56)	0.60	(0.42)	-0.32	(0.60)	0.57	(0.44)
2006	-0.14	(0.66)	0.56	(0.42)	0.00	(0.62)	0.63	(0.42)
2007	0.29	(0.62)	0.54	(0.41)	0.27	(0.62)	0.56	(0.42)
2008	0.03	(0.72)	0.51	(0.42)	0.09	(0.61)	0.64	(0.41)
2009	0.13	(0.69)	0.53	(0.44)	0.15	(0.57)	0.68	(0.42)
2010	0.00	(0.72)	0.51	(0.44)	-0.04	(0.49)	0.77	(0.38)

Table 4.5: Factor loadings of factor analysis for Finance.

The point estimates of Finance's position between Industry and Labor are shown in Figure 4.4. For each country, the latent degree of Finance's interest congruence with either Labor or Industry in 1997 are displayed. Higher values indicate concurrence with the interests of Industry, while lower values indicate more agreement with Labor.

4.4.5 Identification of coalitions

The results from these bayesian factor analysis models provide information on the position of Labor with respect to Industry and Finance, of Finance with respect to Labor and Industry, and of Industry with respect to Finance and Labor. However, this information needs to be integrated into a single categorical variable that indicates the type of coalition present in a particular country for a given year.

For this reason, the point estimates obtained from the factor analyses are used to create a categorical dummy variable indicating to which other actor a particular actor is closest. As the bayesian factor analysis model used here produces results that are centered on the absolute value of zero, I can use it as a 'natural' cut-point.² Labor in countries with positive latent scores are assumed to share interests with Industry, while countries with negative scores are classified as sharing interests with Finance. I repeat this exercise for both Industry and Finance.

The resulting dummies for Labor, Industry and Finance indicate the preferred coalition partner of each actor in a particular year. Combining the information of the three dummies in a particular year's results is straightforward as the pattern must fall into one of the eight possible combinations displayed in Table 4.1. Recording the particular combination of each country-year allows me to create a categorical variable that classifies each country-year as either a Corporatist coalition, Capital coalition, Consumer coalition, or the intransitive situation.

² For a more thorough discussion of this decision see Section 4.5.1.

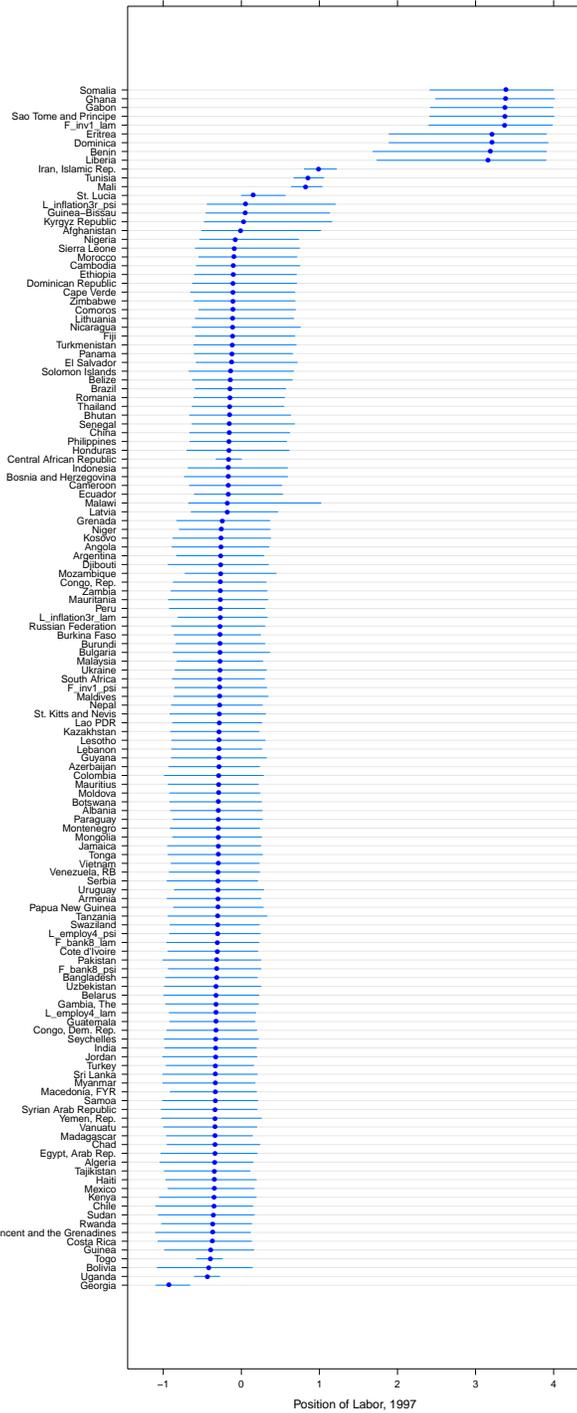


Figure 4.2: Latent degree of Labor's interest congruence with Finance or Industry in 1997

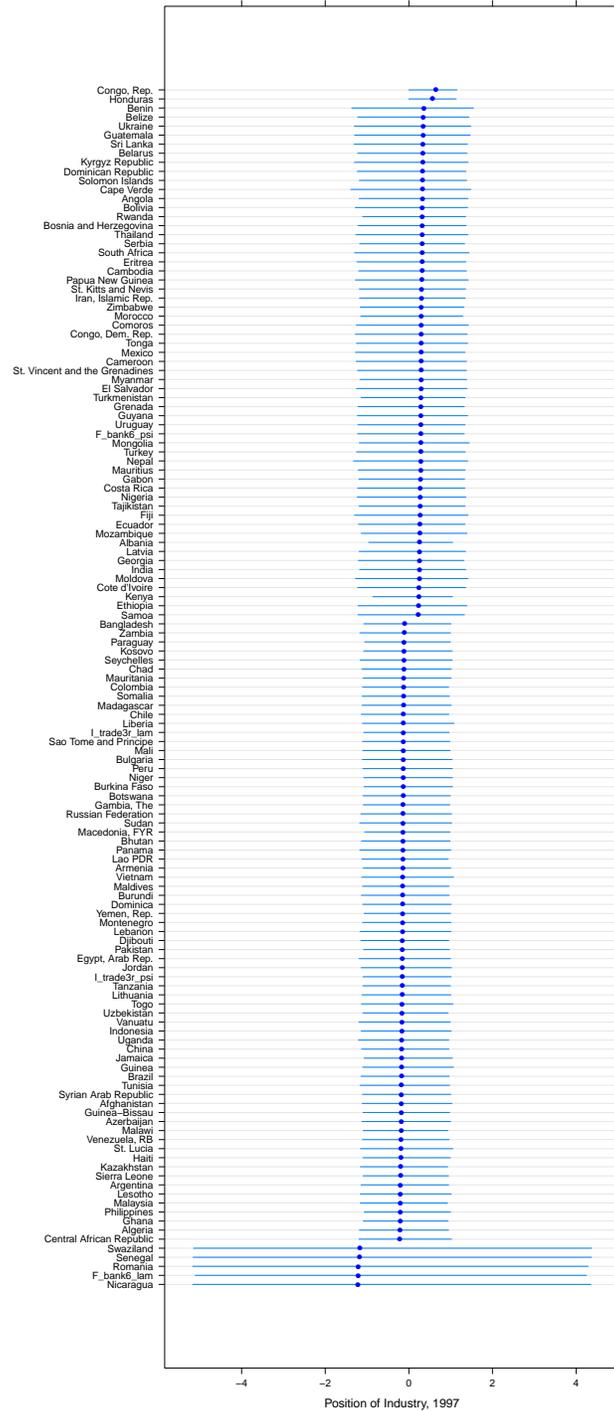


Figure 4.3: Latent degree of Industry's interest congruence with Labor or Finance in 1997

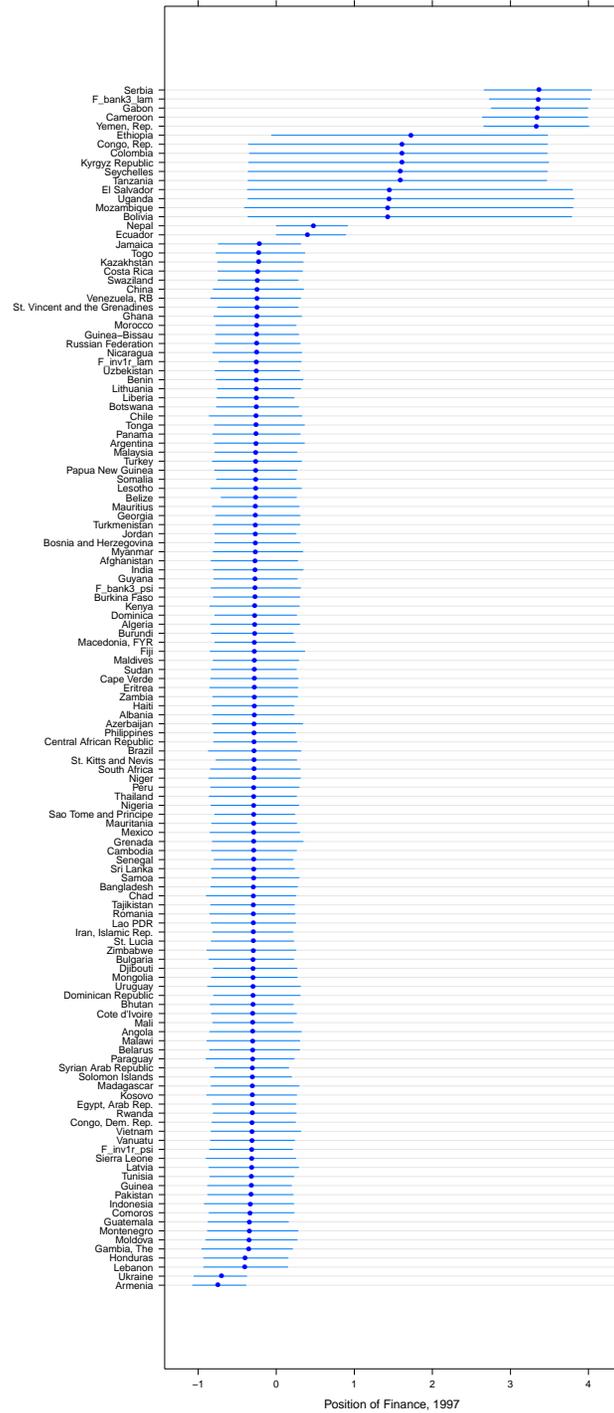


Figure 4.4: Latent degree of Finance's interest congruence with Labor or Industry in 1997

4.5 Latent Profile Analysis to estimate actor positioning

4.5.1 Limitations of factor analysis

The continuous latent variable resulting from the factor analysis above is an intuitive way to represent the positions of Labor, Industry and Finance with respect to the remaining two actors. However, the theoretical model of informal coalition formation proposed in Section 4.3 suggests that an informal coalition exists if the interests of two actors are congruent. In other words, if Labor's position is closer to Industry than to Finance and simultaneously Industry's ideal point is closer to Labor than Finance politicians have the incentive to think of an informal coalition between Labor and Industry. This requires that the position of each actor that was obtained on a continuous scale be transformed to a categorical variable that classifies actors as being closer to the one or the other alternative.

This raises the question of how to define the cut-off point that determines whether an actor is closer to one or the other alternative. Confronted with estimates of a continuous latent variable the researcher is forced to make several decisions: Should one use the mean factor score of the sample in a given year as the cut-off point or would the median be more appropriate? Or should the researcher choose an absolute value, which might be conceivable as the model produces estimates that theoretically should center on zero. Whichever criterion is used, the researcher will still need to decide on which sample to apply the criterion. Should the mean (median, etc). be calculated based on the cross-section of the respective year, or across the pooled set of all country-years? Alternatively, the mean (median) might be calculated for each country separately based on the historical values of the actor in that country. Essentially, when confronted with an estimate of a continuous latent variable, the research must make an *ad hoc* decision concerning the subsequent classification instead of letting the data determine the classification in the first place. This is a serious drawback of a factor analysis in the context of the problem at hand.

Secondly, as evidenced by the results in Section 4.4.3, the factor analysis implemented

above did not always result in a good fit of the data. One of the reasons for such findings might be that the factor analysis model implemented above does not allow for correlations between the observed variables that were used to calculate the latent concept. For example, the method assumes that measures such as inflation and employment are independent from each other. This is clearly a highly questionable assumption as it is likely that inflation and employment co-determine each other. We should therefore use a method that would allow us to incorporate such correlations across constituent variables.

Lastly, recall that the factor analysis above required a separate estimation for each year between 1990 and 2010. This precludes any possibility of incorporating temporal dependence across years, so that being characterized by a Corporatist coalition in year t is assumed to not have any effect on the type of coalition present in year $t + 1$. This is again a highly questionable assumption. Political scientists have a long tradition of identifying path dependencies within political processes as well as the effect of institutions shaping the overall context of politics in ways that reproduce themselves over time. It is therefore necessary to utilize a method that allows for the incorporation of temporal dependence when estimating the coalition present at time $t + 1$.

4.5.2 The model

Considering these shortcomings of the factor analysis estimations obtained in Section 4.4, this section presents an alternative model that will address the shortcomings discussed above. I propose estimating a latent profile analysis with modifications that allow for the incorporation of both temporal and contemporaneous correlations.

As indicated in Table 4.2, latent profile analysis assumes that the observable indicators are continuous while the underlying latent variable is categorical. The literature on latent variable models actually does not emphasize the difference between latent factor models that assume a continuous latent variable and latent profile models that suggest a categorical latent variable. For normally distributed data, a latent factor model and a latent profile

model can account for the observed correlations equally well. One example is Berry (1997) whose theory allows for the continuous as well as categorical interpretation of the underlying variable. An analogy might clarify why the conceptual distinction between a continuous and categorical variable is not salient. Assume that we estimate the latent propensity of alcohol consumption to examine its effect on health outcomes. Whether one considers high alcohol use on a continuous scale or the category of heavy drinkers vs. occasional drinkers is not central as the result of the analysis will be similar: excessive consumption of alcohol will have negative health consequences. The literature therefore suggests that researchers can pick the type of analysis that theory suggests is most appropriate. Considering the discussion on the challenges of identifying an actor's favored coalition partner, my coalitional theory would suggest that a latent profile analysis that assumes a categorical latent variable is more appropriate than a latent factor analysis.

I therefore develop and implement a latent profile model that also addresses the additional issues of contemporaneous correlation among constituent variables and intertemporal correlation across coalition estimates for particular years. The goal is to identify three categorical variables that indicate the preferred coalition partner of each actor. In other words, one categorical indicator would represent whether Labor's interests are closer to Finance or Industry, while the remaining two categorical variables would do the same for Industry and Finance respectively.

An illustration of this model is presented in Figure 4.5. The rectangles represent observed variables whereas the circles represent the categorical latent variables. At $t = 1$, the three observable indicators x_1 , x_2 and x_3 are used to calculate the latent categorical variable c_1 at $t = 1$. The estimation of this direct relationship is represented by the straight arrow. Importantly, while estimating c_1 , x_1 through x_3 are allowed to correlate as indicated by the dotted lines. This modeling decision addresses the concern raised in the context of factor analysis where variables such as inflation and employment were viewed as completely unrelated.

I incorporate the possibility of inter-temporal correlation as well. As discussed above, due to path dependencies and historical legacies it is reasonable to expect that past coalitions affect the formation of future coalitions. I model this possibility by allowing any estimation of c_n with $n > 1$ to be determined

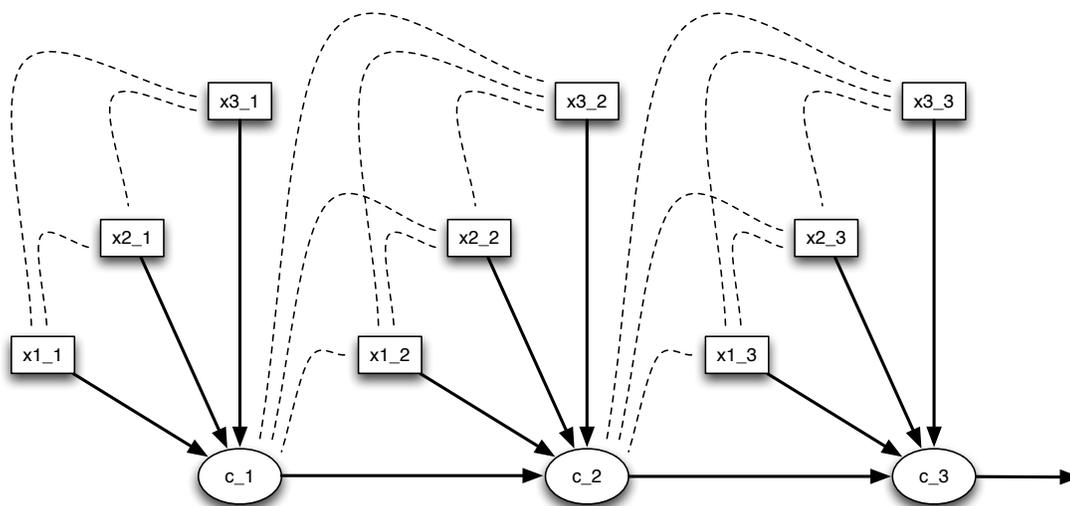


Figure 4.5: Illustration of Latent Profile Model estimated. The rectangles represent observed variables while the circles represent latent variables. Subscripts indicate time period.

The implementation of this model is achieved by estimating a latent profile analysis with the structural conditions outlined above. Identification is achieved by fixing three cross-correlations to the constant 1. The default estimator for this type of analysis is maximum likelihood with robust standard errors. When estimating the factor analysis in Section 4.4 I was required to conduct a total of 21 separate estimations (3 latent variables, one of each actor, times 7 years, one for each cross-section between 2004 and 2010³).

³ The decision to estimate the latent profile analysis for this time period only was derived from considerations that will be more fully developed in Chapter 5. In short, my theory suggests that countries have a choice between BRIC creditors and traditional creditors. However, BRIC loans have been available only recently. In order to adequately model a government's choice of creditor, then, it is necessary to only consider the time period when the full set of loan options was available. As the first BRIC loan larger than 1 billion US\$ was granted in 2004 I assume that this was the time when BRIC creditors were 'large enough'

In contrast, the latent profile analysis only requires three estimations: a single categorical variable indicating the preferred coalition partner of each actor across time and for each country in the sample.

4.5.3 Estimating the positions of Labor, Industry and Finance

While the latent profile model differs dramatically from the factor analysis implemented in Section 4.4, I use the same set of constituent observable variables to estimate the underlying latent variable. Consequently, when estimating the position of Labor with respect to Finance and Industry, I use the employment in industry as a percentage of total employment to capture how dependent Labor is on Industry in terms of employment opportunities. Second, inflation as measured by the annual percentage of consumer price increases, is used to represent Labor's concern with respect to inflation. I again include the gross fixed capital formation in the private sector as a percentage of GDP to capture the benefits of increased employment opportunities as a result of domestic investment. Lastly, the net inflow of foreign direct investment is used to proxy the employment opportunities created by foreign investors as opposed to domestic Industry.

The results of the latent profile analysis for Labor are summarized in Table 4.6. Countries belonging to class 1 are characterized by Labor whose interests are congruent with those of Industry, while countries classified as class 2 feature Labor whose interests are aligned with those of Finance. As can be seen, the proportion of countries in the two classes is roughly constant across time, with about half of the 129 countries in the sample falling into each category.

However, the aggregate numbers do not necessarily speak to the stability of classifications for individual countries over time. Table 4.7 therefore presents the means for the constituent variables across time for the three most common patterns of classification.⁴

to be a serious alternative to traditional creditors.

⁴ The decision to present only three classification patterns is due to space considerations. There are, after all – with countries being assigned to two classes over seven years – a total of 128 classification patterns possible.

Year	Class	Count	Proportion
2004	1	63.66	0.50
	2	64.34	0.50
2005	1	63.66	0.50
	2	64.34	0.50
2006	1	62.38	0.49
	2	65.62	0.51
2007	1	55.42	0.43
	2	72.58	0.57
2008	1	55.42	0.43
	2	72.58	0.57
2009	1	55.42	0.43
	2	72.58	0.57
2010	1	55.42	0.43
	2	72.58	0.57

Table 4.6: Aggregate summary of the latent variable indicating the position of Labor based on estimated posterior probabilities.

Labor's position with respect to either Finance or Industry is stable as two of the three most common classification patterns do not change over time. They remain classified as class 1 (positioning close to Industry) or class 2 (interests aligned with Finance) for all seven years. In some countries, however, Labor changes positions over time. The most common pattern for these countries shows that Labor is aligned with Industry for the first three years and then moves closer to Finance in the remaining years.

I implement latent class analysis for Industry with the same constituent variables that were already used in the factor analysis. To capture the degree to which Industry caters to Labor, I include the imports of goods and services as a percentage of GDP, as high imports indicate Industry's dependence on the general population as consumers. Industry's propensity to cater to the export market is incorporated by the inclusion of the real effective exchange rate index (2005 = 100). As an appreciation of the exchange rate makes exports uncompetitive, higher values on this index imply that Industry will be less inclined to cater to the export market.

Table 4.8 presents the summary statistics of the resulting classifications. Countries classified as class 1 are characterized by Industry whose position is close to that of Finance. Industry in countries that fall into class 2, on the other hand, is characterized by interests

		Pattern 1 1 1 1 1 1 1			Pattern 1 1 1 2 2 2 2			Pattern 2 2 2 2 2 2 2		
		Estimate	SE	p-value	Estimate	SE	p-value	Estimate	SE	p-value
Inflation	2004	-12.34	5.28	0.02	-12.34	5.28	0.02	-6.29	0.69	0.00
	2005	-12.98	5.04	0.01	-12.98	5.04	0.01	-6.55	0.55	0.00
	2006	-27.90	20.09	0.17	-27.90	20.09	0.17	-6.44	0.59	0.00
	2007	-8.67	1.07	0.00	-5.91	0.53	0.00	-5.91	0.53	0.00
	2008	-14.64	1.41	0.00	-10.84	0.72	0.00	-10.84	0.72	0.00
	2009	-6.64	1.09	0.00	-4.21	0.58	0.00	-4.21	0.58	0.00
	2010	-6.49	0.88	0.00	-4.47	0.40	0.00	-4.47	0.40	0.00
Employment in industry	2004	16.57	1.26	0.00	16.57	1.26	0.00	22.71	1.09	0.00
	2005	14.11	2.12	0.00	14.11	2.12	0.00	22.24	1.44	0.00
	2006	18.49	1.46	0.00	18.49	1.46	0.00	23.03	1.33	0.00
	2007	17.98	2.02	0.00	23.99	1.06	0.00	23.99	1.06	0.00
	2008	17.93	2.16	0.00	24.40	1.10	0.00	24.40	1.10	0.00
	2009	13.40	3.83	0.00	22.60	1.20	0.00	22.60	1.20	0.00
	2010	18.10	0.81	0.00	25.40	1.86	0.00	25.40	1.86	0.00
Domestic investment	2004	10.60	0.88	0.00	10.60	0.88	0.00	18.95	1.21	0.00
	2005	12.51	0.91	0.00	12.51	0.91	0.00	19.33	1.10	0.00
	2006	12.51	1.25	0.00	12.51	1.25	0.00	19.40	0.85	0.00
	2007	12.23	1.11	0.00	20.24	0.95	0.00	20.24	0.95	0.00
	2008	12.30	1.17	0.00	20.50	0.97	0.00	20.50	0.97	0.00
	2009	10.85	0.91	0.00	19.05	0.80	0.00	19.05	0.80	0.00
	2010	11.94	0.95	0.00	18.56	0.82	0.00	18.56	0.82	0.00
FDI	2004	4.72	0.64	0.00	4.72	0.64	0.00	3.94	0.85	0.00
	2005	4.47	0.70	0.00	4.47	0.70	0.00	4.05	0.78	0.00
	2006	7.23	1.18	0.00	7.23	1.18	0.00	4.37	0.69	0.00
	2007	8.07	1.52	0.00	5.65	0.78	0.00	5.65	0.78	0.00
	2008	8.93	1.64	0.00	5.18	0.70	0.00	5.18	0.70	0.00
	2009	6.82	1.27	0.00	3.74	0.52	0.00	3.74	0.52	0.00
	2010	7.17	1.49	0.00	3.69	0.54	0.00	3.69	0.54	0.00

Table 4.7: Means of constituent variables by latent class pattern for Labor.

closer to those of Labor. Again, the aggregate proportion of the two classes is stable over time.

Analyzing the classification patterns of individual countries reveals that the aggregate stability of classifications is again caused by the consistent classification of individual countries over time. As shown in Table 4.9 the pattern 1111111 (indicating that the country was always identified as class 1) and the pattern 2222222 (always coded as belonging to class 2) are among the three most common classification patterns. In these countries, Industry's interests are always aligned with those of Finance (class 1) or always congruent with those of Labor (class 2). However, there are countries characterized by Industry whose position

Year	Class	Count	Proportion
2004	1	45.18	0.36
	2	80.82	0.64
2005	1	45.18	0.36
	2	80.82	0.64
2006	1	45.18	0.36
	2	80.82	0.64
2007	1	45.18	0.36
	2	80.82	0.64
2008	1	46.64	0.37
	2	79.36	0.63
2009	1	49.07	0.39
	2	76.93	0.61
2010	1	49.07	0.39
	2	76.93	0.61

Table 4.8: Aggregate summary of the latent variable indicating the position of Industry based on estimated posterior probabilities.

with respect to Finance and Labor changes over time. Of these countries, the most common pattern exhibits Industry being aligned with Finance initially and then moving closer to Labor.

		Pattern 1 1 1 1 1 1 1			Pattern 2 2 2 2 2 1 1			Pattern 2 2 2 2 2 2 2		
		Estimate	SE	p-value	Estimate	SE	p-value	Estimate	SE	p-value
Imports	2004	-67.09	5.19	0.00	-35.46	2.07	0.00	-35.46	2.07	0.00
	2005	-69.37	5.03	0.00	-36.37	2.18	0.00	-36.37	2.18	0.00
	2006	-70.77	5.36	0.00	-36.07	2.45	0.00	-36.07	2.45	0.00
	2007	-72.83	5.71	0.00	-36.68	2.44	0.00	-36.68	2.44	0.00
	2008	-74.33	6.04	0.00	-38.35	2.72	0.00	-38.35	2.72	0.00
	2009	-63.54	4.55	0.00	-63.54	4.55	0.00	-34.25	2.79	0.00
	2010	-65.59	4.25	0.00	-65.59	4.25	0.00	-34.81	3.15	0.00
Real	2004	99.60	0.45	0.00	96.13	1.36	0.00	96.13	1.36	0.00
Exchange	2005	100.00	0.01	0.00	100.00	0.00	0.00	100.00	0.00	0.00
Rate	2006	100.68	1.02	0.00	103.63	1.07	0.00	103.63	1.07	0.00
	2007	100.56	1.62	0.00	105.51	1.55	0.00	105.51	1.55	0.00
	2008	104.14	3.15	0.00	111.00	2.52	0.00	111.00	2.52	0.00
	2009	107.07	3.04	0.00	107.07	3.04	0.00	124.55	13.60	0.00
	2010	106.63	2.70	0.00	106.63	2.70	0.00	138.93	25.41	0.00

Table 4.9: Means of constituent variables by latent class pattern for Industry.

Lastly, I estimate the latent profile analysis for Finance using the same set of constituent variables as with the factor analyses for Finance reported above. Recall that Finance's position between Industry and Labor is determined by the degree to which it is the main

provider of finance to domestic industry. I therefore use the total claims existing on the private sector (measured as annual growth as a percentage of broad money) to capture the notion that the more financing Finance has provided to domestic industry, the more entangled it is with Industry's economic wellbeing. Second, I utilize the net inflows of foreign direct investment as a percentage of GDP to measure the degree to which foreign investors might provide the funding necessary for investment projects that otherwise would have been supplied by domestic Finance. I therefore assume that higher FDI implies more competition for domestic Finance which implies that Finance's interests are less likely to be aligned with those of domestic Industry.

Aggregate classification patterns resulting from this latent profile analysis are presented in Table 4.10. Countries that fall into class 1 are characterized by Finance whose interests are aligned with those of Industry, while class 2 captures instances of congruent interests of Finance and Labor. It is intuitive that in the large majority of cases Finance's interests are closer to those of Industry than Labor.⁵

Year	Class	Count	Proportion
2004	1	112.37	0.88
	2	15.63	0.12
2005	1	112.37	0.88
	2	15.63	0.12
2006	1	114.57	0.90
	2	13.43	0.10
2007	1	112.86	0.88
	2	15.14	0.12
2008	1	110.15	0.86
	2	17.85	0.14
2009	1	10.26	0.08
	2	117.74	0.92
2010	1	10.26	0.08
	2	117.74	0.92

Table 4.10: Aggregate summary of the latent variable indicating the position of Industry based on estimated posterior probabilities.

⁵ The fact that this changes in the years 2009 and 2010 might be the result of the global financial crisis that occurred in 2007 and 2008. In the aftermath of such a crisis it is reasonable to expect that Finance would turn away from large investment banking activities and focus on the core businesses of offering financial services to the general population.

The aggregate pattern of classifications appears to be stable over time. As was the case with Labor and Industry, this stability is based on the consistent classification of individual countries over time. Among the three most common classification patterns are again the cases where Finance is consistently classified as being closer to Industry than Labor (pattern 1111111) as well as the opposite case (pattern 2222222). Amongst the instances where Finance exhibits a change in relative position between Industry and Labor the pattern 1111122 is most common, indicating that Finance starts being aligned with Industry and only for the last two years moves closer to Labor.

		Pattern 1 1 1 1 1 1 1			Pattern 1 1 1 1 1 2 2			Pattern 2 2 2 2 2 2 2		
		Estimate	SE	p-value	Estimate	SE	p-value	Estimate	SE	p-value
FDI	2004	-3.73	0.33	0.00	-3.73	0.33	0.00	-8.73	3.41	0.01
	2005	-3.74	0.39	0.00	-3.74	0.39	0.00	-8.14	2.79	0.00
	2006	-5.76	0.57	0.00	-5.76	0.57	0.00	-5.64	1.46	0.00
	2007	-6.71	0.62	0.00	-6.71	0.62	0.00	-6.35	2.52	0.01
	2008	-6.88	0.74	0.00	-6.88	0.74	0.00	-6.11	1.59	0.00
	2009	-19.93	2.43	0.00	-3.76	0.31	0.00	-3.76	0.31	0.00
	2010	-23.47	3.44	0.00	-3.57	0.30	0.00	-3.57	0.30	0.00
Claims on private sector	2004	8.12	1.54	0.00	8.12	1.54	0.00	39.83	8.97	0.00
	2005	10.50	1.23	0.00	10.50	1.23	0.00	44.54	10.26	0.00
	2006	12.24	1.76	0.00	12.24	1.76	0.00	56.86	18.61	0.00
	2007	14.71	2.32	0.00	14.71	2.32	0.00	70.26	18.76	0.00
	2008	13.07	1.37	0.00	13.07	1.37	0.00	38.39	6.54	0.00
	2009	1.12	3.80	0.77	6.51	0.91	0.00	6.51	0.91	0.00
	2010	5.98	3.45	0.08	9.34	1.00	0.00	9.34	1.00	0.00

Table 4.11: Means of constituent variables by latent class pattern for Finance.

Following the estimation of the three latent profile analyses for Labor, Industry and Finance I follow the method outlined in Section 4.4.5 to construct a categorical variable indicating the type of coalition present. For each country-year, I therefore examine which two of the three actors have congruent interests, that is, which actors prefer the respective other as their coalition partner. As the possible combinations of preferred coalition partners must fall into one of the eight possible configurations displayed in Table 4.1, I can create a categorical variable that classifies each country-year as either a Corporatist coalition, Capital coalition, Consumer coalition, or the intransitive case.

4.6 Appraisal

The challenge presented by the theory put forward in Chapter 2 is to connect a set of unordered actors (Labor, Industry and Finance) to a set of unordered coalitions (Capital, Corporatist and Consumer), which in turn are to be connected to a set of unordered borrowing options (BRICs, DACs, IFIs and private creditors). The theory of informal coalition formation proposed in Section 4.3 provides a solution for the first step of connecting actors to informal coalitions. By assuming that politicians have the incentive to cater to two out of the three actors simultaneously, the model elegantly provides both a causal mechanism through which informal coalitions might be formed as well as a way to operationalize the concept of informal coalitions. In addition, the theory is also able to address situations in which no informal coalition was present by allowing for intransitive configurations of interests. The ability to account for this possibility is a contribution to the existing literature of coalition formation.

A second conceptual strength of this coalition model is its applicability to both democracies and non-democracies. Admittedly, it is more intuitive in the context of democracies to assume that office-motivated politicians observe the structural conditions of the political economy in order to infer whose interests are aligned that then can be catered to simultaneously. However, existing research on the politics of non-democratic regimes has reached the consensus that even in these countries political competition is at play. Weeks (2008, 2012) shows that conventional wisdom significantly underestimates the degree to which autocratic leaders are held accountable domestically. A large body of literature following Bueno de Mesquita et al. (2005) shows that in non-democracies leaders have to

With respect to the empirical implementation, my theory of informal coalition formation holds several advantages. First, data for this type of analysis is widely available both across time and across a large set of countries. This is an improvement over the need to find data on unionization rates in developing countries in order to capture Labor's strength. Further, working with latent variable approaches avoids the need for proxies

but implements the theoretical notion of an *informal* coalition directly into the statistical model. Latent variable models allow researchers to explicitly model the direct relationship between observable indicators and the underlying latent concept. Further they also allow scholars to account for the contemporaneous correlation among the observable indicators. More importantly, latent variable models can be modified to incorporate inter-temporal correlation. In a context characterized by historical legacies and path dependencies it is important to recognize that yesterday's informal coalition is likely to have an effect on the informal coalition present today. The empirical strategy I pursued in this chapter allows me to incorporate these considerations directly into the statistical model.

Nevertheless, the approach proposed in the chapter does have drawbacks. On a theoretical level, my model requires strong assumptions. For example, I suggest that politicians are office-motivated and have no interests besides re-election. The possibility of policy-motivated politicians is excluded. In addition, the model suggests that informal coalitions are formed on the basis of interest congruence but ignores the relative 'strength' of actors.

It is undoubtedly plausible to take the relative power of actors into consideration. However, I argue that the focus on the strength of Labor, Industry and Finance also necessitates strong assumptions as strength alone does not provide information on which actors will form a coalition: that the two strongest actors form a coalition of strength, or that smaller actors collaborate to be jointly more powerful than the single strong actor. In addition, it is challenging to obtain data on the relative strength of various domestic groups. One might think about using union coverage as a proxy for Labor strength. However, such data is often not available for developing countries, and even if it is, it might not capture the concept of interest. For example, Labor is a powerful actor in Ecuadorian politics, yet the Labor force is by and large not unionized. Such discrepancies preclude the possibility of finding a measure of an actor's strength that could be used with confidence.

Chapter 5

Predicting the Composition of New Loans – An Inference Model

5.1 Data

5.1.1 The dependent variable

In Chapter 4, I create a measure indicating what type of coalition characterizes a particular country in a specific year. In this chapter, I use this newly created variable to test whether governments' borrowing decisions are explained by the type of coalition present.

Such an analysis requires data on the loans obtained by developing countries. Data on the loan amounts extended by the traditional creditors – the IFIs, DACs and private creditors – is readily available. However, this is not the case for the BRICs. In particular, China treats data on the loan amounts extended by its lending institutions as state secrets. In addition to the dollar amount lent, I will need data under the terms on which the money is lent. I will utilize information on the 'price' of loans to control for the possibility that the cost of loans affects borrowing decisions. Unfortunately, obtaining data on the interest rate, grace period or maturity of loans is challenging not only for emerging creditors. Even

traditional creditors do not provide systematic information on the conditions of their loans.

Existing work has tried to address this issue by focusing on the supply side. For instance, scholars such as Brautigam (2009) have poured much effort into obtaining more detailed information from the Chinese on their lending volume and terms. The Chinese Statistical Yearbook provides some aggregated data on the total Chinese lending volume to the entire world, sometimes broken down by region. Scholars have therefore attempted to disaggregate this data in order to derive the loan amounts given by the Chinese to individual countries. Others have attempted to obtain information on the terms of these loans by undertaking fieldwork in Beijing with the intention of speaking with Chinese loan officers in the headquarters of lending institutions such as the Chinese Development Bank. So far, these attempts have been unsuccessful in obtaining systematic data on the lending volume and terms of BRIC lenders.

Faced with this challenge, I chose to pursue a different route to obtain this data. Instead of focusing on the supply side of lending by estimating the capital outflows from BRICs to developing countries, I concentrated my efforts on the demand side. Every loan extended by a creditor must have a recipient. It therefore should be possible to ‘look through the books,’ so to speak, of developing countries in order to determine which creditors they have used in the past. By systematically exploring their capital inflows, I am able to reverse-engineer information on the lending activities by BRICs. At the same time, this approach allows me to obtain comparable data across all types of creditors. For example, in the case that western governments have an incentive to underreport loans to particular countries, the strategy of focusing on the recipient side will allow me to uncover such behavior.

I was fortunate to be granted access to the internal databank of the World Bank to accomplish this undertaking. As a membership organization, all members of the World Bank not only have certain rights but also some obligations. One of these is the requirement for each country to report detailed information on their financial position in the context of the Debtor Reporting System (DRS). This includes information on their revenues and

expenses, disaggregated to an extraordinary level of detail. On the revenue side, governments are required not only to report data on income from taxes, but also on transfers of external resources such as foreign aid as well as loans from external creditors. The World Bank granted me access to the latter, which allowed me to compile a dataset that includes information on all loans obtained by developing countries as well as the terms upon which these loans were acquired. The coverage of this data is exceptional, considering that World Bank membership is almost universal among developing countries (see Section 3.2)

However, there are some limitations of the data acquired using this approach. First and foremost is that fact that the data was obtained from the *internal* databank of the World Bank. As such, the information acquired is of confidential nature, as governments have reported their information on the sources of income on good faith terms to the World Bank. To quote the email of a World Bank official “by supporting your work we are exposing creditors based on debtor’s data, which is always a concern to us.” By securing access to this data I was required by the World Bank to sign waivers that prohibit me from distributing this data myself, and restrict publication of the information to forms that prevent the identification of particular loans. I recognize that this is a serious obstacle to the spirit of replication that governs academic work. However, in order to make replication possible I offer fellow researchers the following: I will make my entire dataset available to researchers, with the exception of the four variables that contains information on lending volumes and the respective terms (interest rate, grace period, maturity). In order to obtain these four variables, I ask interested researchers to contact me directly in order to obtain the contact information of my contact at the World Bank as well as the file number of my request. This will allow researchers to acquire the same data I obtained directly from the World Bank. All data is therefore available to researchers interested in replicating my findings.

With respect to the data itself, there are additional limitations. As indicated above, the information on creditors is obtained based on data by debtors. There is the possibility

of debtors underreporting the loan amounts obtained from particular creditors. For example, governments might be less inclined to be forthcoming about loans obtained from emerging creditors when reporting their data to the World Bank, a traditional creditor. However, similar limitations exist with respect to data provided by creditors themselves: western governments might want to underreport their loans to non-democratic countries. In contrast, data obtained from an international organization that has observers in each member country and therefore some degree of insight into whether the data reported is accurate is superior to data that was compiled without any supervision.

The data obtained from the World Bank is more disaggregated than any other data currently available on BRIC lending. Nevertheless, the information obtained only includes information on the totals received by a particular country in a particular year. I therefore cannot differentiate between the case where a creditor grants one large loan or two separate small loans. Accordingly, the information on interest rate, grace period and maturity are averages for all loans obtained by a specific creditor in a specific country-year.

In addition, some loan amounts received are recorded as ‘other’ or ‘unspecified’ due to reporting problems over the years. The World Bank therefore provided this data under one category called ‘other’ which is not comparable across countries. As it cannot be used in a cross-country fashion, I have excluded this information from the analysis.

Lastly, the World Bank data did not include all information required for my analysis. For example, short-term debt, private non-guaranteed debt data and IMF debt data were all compiled at an aggregate level. This implies that there is no information on the average terms for these categories. In addition, the DRS did not include data on private creditors. However, information on both IMF loans as well as private creditors is available from the World Development Indicators (World Bank, 2012). With respect to the latter, the data includes information on the total amount obtained for each country-year. However, no data is available on the identity of the private creditors. I therefore do not know which banks have granted syndicated loans and the identity of the bond holders is unknown.

Despite these limitations, the data obtained represents a major advance in the study of lending activities, particularly with respect to BRICs. My dataset is the first that features systematic information on four types of creditors – IFIs, DACs, BRICs and private creditors – not only on their respective lending volume but also the terms of the loans (i.e. interest rate, maturity and grace period). This data is disaggregated and therefore available for 129 developing countries over the period from 1970 through 2010. Such detailed coverage on a disaggregated basis is unprecedented in the literature to date.

5.1.2 The independent variable

The independent variable of importance is the type of coalition present in a recipient country. In short, if a country is characterized by a Corporatist coalition, I expect its government to favor borrowing from BRIC creditors at the expense of private and IFI loans. In contrast, if a Capital coalition is present, I hypothesize that the government will prefer loans from private creditors and, to a lesser degree, from IFIs. Lastly, a Consumer coalition is expected to lean towards DAC loans.

The data regarding what country is characterized by which type of coalition was derived in Chapter 4. I incorporate this information by using dummies indicating the type of coalition present in a particular country-year. This results in a total of four dummies for the Corporatist, Capital and Consumer coalitions, as well as the situation of intransitive preference orderings where no coalition is formed. Of these four dummies I exclude the dummy for the Corporatist coalition to avoid dummy variable trap. Excluding the Corporatist coalition facilitates interpretation as the remaining dummies then indicate the degree of difference between the base category and the type of coalition captured by the respective dummy.

5.1.3 The control variables

Besides the dependent and the independent variable of importance, I also include a number of control variables. In the remainder of this chapter I will introduce a variety of models that may be used to test my theory. It is important to note, however, that in order to facilitate comparison across models, I will use the same set of control variables in each of the models.

For example, in each model I control for the cost of the loans by including the interest rate, the grace period and the maturity of each loan. While I could have used the grant element implicit in each loan, this measure only aggregates the information on the interest rate, maturity and grace period into a common scale. However, as it is of interest whether governments respond more to one aspect of loan costs than another, I include these variables separately. This data was obtained from the World Bank along with the loan data described in Section 5.1.1. I also control for the total external debt stock of each borrower, measured as a percentage of GNI, at the time of the current borrowing decision. This accounts for the possibility of not obtaining additional loans if the existing debt stock is already comparatively large. In addition to these controls applicable to all types of creditors, I also include additional controls to account for creditor-specific factors.

BRICs With respect to BRIC loans, a number of scholars have suggested that China only lends to countries that do not recognize the political sovereignty of Taiwan (Large and Chien, 2008; Ellis, 2009; Dreher and Fuchs, 2011). I therefore include a dummy variable obtained from Rich (2009) to control for the possibility that China favors countries that do not recognize Taiwan.

In addition, researchers have indicated that emerging creditors use loans as a means to obtain access to natural resources in the recipient countries (Rotberg, 2008; Melber, 2008, 2009). If this is the case, countries with natural resources should obtain more and larger loans from BRICs. I therefore include a measure of the total natural resource rents

developed by the World Bank (2012) in the respective recipient countries.

DACs Scholars have also suggested variables that explain lending from DACs to developing countries. In particular, along the lines of the literature on foreign aid, it is argued that western countries use loans (either bilateral loans or indirectly through the IMF) to buy their governments votes in international organizations such as the United Nations (Kuziemko and Werker, 2006; Dreher, Sturm and Vreeland, 2008). To control for this possibility, I follow Copelovitch (2010*a*) and include the average S-score of the G5. The variable is based on the S-score data by Strezhnev and Voeten (2012) and captures the degree of voting similarity between the G5 as a group (i.e. the US, the UK, France, Germany and Japan) and each developing country.

IFIs The IMF has long been a subject of academic inquiry, producing several theories explaining its lending determinants. However, as a member organization dominated by western governments, the explanations proposed are interwoven with those of DACs, as discussed above, and private creditors from western countries as will be discussed below. I nevertheless include an additional variable to account for factors that might affect IMF lending in particular, independent from the influence of western governments or private creditors. Section 3.2 discusses in detail how IMF membership determines whether or not a government has the right to borrow from the IMF. I therefore include a dummy indicating IMF membership in the estimations obtained from the IMF (2013*b*).

Private creditors Conventional wisdom suggests that private creditors are risk adverse. Following the work of Tomz (2007) defaulting on existing debt or building up arrears on payments due would destroy the confidence of private creditors who would subsequently stop lending to countries classified as high risk. To control for this possibility I include data on the arrears on principal and interest payments due which are available from the World Bank (2012). First, I account for the arrears on debt obtained from official creditors such

as the IMF. Scholars have argued that the IMF has a certain signaling capacity, allowing the organization to act as a catalyst for private capital flows to developing countries. This applies both in the positive as well as the negative sense. In other words, no arrears on debt owed are a positive signal, while arrears on principal or interest payments to official creditors are understood to be a negative sign. In particular, it is argued that private lending is highly sensitive to the repayment status of official loans. I therefore add the arrears on principal and interest owed to private creditors. By controlling for official arrears as well as private arrears, I can account for the possibility that private creditors react more heavily to missed payments, which may represent early warning signs of a country's imminent default.

Note that there are two reasons why I chose to account for a country's risk by including its arrears instead of using that country's sovereign debt rating by rating agencies such as Standard & Poor's, Fitch or Moody's. First, private actors in particular will look out for early warning signs of a default. Paying attention to a country's arrears is therefore likely to provide the information sought faster than waiting for a rating agency to assess the situation and then decide to adjust a country's credit rating. In addition, concerns have been raised regarding the rating agencies' neutrality. I therefore argue that using arrears instead of sovereign debt ratings is a more accurate measurement of default risk. The second reason is pragmatic in nature. The number of countries that have received credit ratings by rating agencies is small in comparison to the countries covered by the World Bank's data. Even when using the average of all bond ratings available from Standard & Poor's, Fitch, and Moody's in order to increase country coverage, I still lose about half of my observations due to missing data on the rating variable alone. In contrast, including the data on payment arrears results in a loss of observations of less than 2%.

Other controls Besides variables that directly pertain to the four types of creditors I include additional controls accounting for country characteristics obtained from the World Bank (2012). For instance, I include the log of GDP per capita to account for differences

in development across recipient countries. Further, the need for external resources might differ across governments. It is reasonable that the degree of necessity for external resources might affect a government's incentive to seek out loans and a creditor's willingness to extend it. To account for a country's need of a loan, I therefore control separately for government income as well as government spending. With respect to the former, I include government revenue (excluding grants) as a percentage of GDP, while the latter is accounted for by incorporating government final consumption expenditure as a percentage of GDP. In addition, the degree to which a developing country is a successful exporter as well as the degree to which a country relies on imports might affect its borrowing strategy. I therefore include both the exports and imports of goods and services as a percentage of GDP as control variables.

5.2 Linear panel model

5.2.1 Model specification

Considering the availability of loan data across both time and recipient countries, the application of panel data estimators is the logical first step. The goal of such an analysis is to predict the expected loan amounts that each type of coalition would obtain from each of the four types of creditors.

I therefore estimate a random effects model of the following form

$$y_{it} = \alpha + \gamma y_{it-1} + \beta x_{it} + \psi z_{it} + \epsilon_{it} \quad (5.1)$$

where t covers the time period from 2004 through 2010. The choice of t is motivated by theory. I argue that governments choose between four types of creditor based on the preferences of the dominant societal coalition. However, BRICs are emerging creditors that have not been active for a long period of time. To apply my theoretical framework onto a time period where BRICs were still inactive would result in biased estimates. For this

reason, I identified the first instance of a BRIC lending more than \$1 billion US dollar, which was a Chinese loan to Angola in 2004. I therefore assume that from 2004 onward BRIC creditors were sufficiently active to be considered by recipient governments as a viable alternative. With the data obtained from the World Bank ending in 2010, the panel is characterized by $t = 7$ and $N = 129$.

A common concern with panel data is the possible presence of serial correlation across time. In short, it might be the case that existing debt would have an effect on a current year's loans. However, the dependent variable measures the new loans obtained in a given year, not the overall debt stock already obtained from a particular creditor. The dependent variable therefore captures the first differences rather than the level of debt, which should moderate concerns about serial correlation. Nevertheless, having established a good working relationship with a particular creditor might provide governments with the incentive to favor that particular creditor over time. To account for this possibility of serial correlation, I follow the common practice of including a lagged dependent variable y_{it-1} to further alleviate such concerns.

In addition to concerns about autocorrelation, my estimates must also address the problem of selection effects. Przeworski and Vreeland (2000) and Vreeland (2003*a*) show with respect to the IMF that the selection into IMF programs may be non-random. In other words, the same variables that explain loan size may also explain the likelihood of obtaining a loan in the first place. Such reasoning applies not only to the IMF. It is reasonable to assume that the likelihood of obtaining a BRIC loan also affects the size of the BRIC loan obtained. To address this selection problem I follow Copelovitch (2010*b*) and employ propensity score matching – albeit modified to take into account the possibility of borrowing from four separate creditors as opposed to Copelovitch's specification that only considers one creditor. I therefore create propensity scores z_1 , z_2 and z_3 that capture the predicted probability of obtaining a BRIC loan, DAC loan or private loan, respectively. The propensity score for IFIs is excluded to avoid the dummy variable trap. Essentially, these

propensity scores measure the probability of obtaining one of the respective loans given the covariates of the observation (i.e. each country-year). The inclusion of these propensity scores implements the idea of matching each observation with a ‘control’ observation for which the values of the explanatory variables are as close to identical as possible.

Including z_{1-3} in the panel regression minimizes selection bias and enables the use of standard, parametric regression techniques (Ho et al., 2007). As such, for example, it allows me to use cluster-robust Huber/White/sandwich estimator that results in an error term ϵ that is identically and independently distributed over the clusters, but correlated within each cluster. Without accounting for this correlation the OLS point estimates would be consistent, while the standard errors of the variance-covariance estimation would not.

5.2.2 Results

The results of the panel regressions are displayed in Table 5.1. As noted above, I estimate Equation 5.1 in four separate specifications. In model 1, the dependent variable is the logged loan amount obtained from BRICs. Consequently, the lagged dependent variable refers to the lagged log loan amount acquired from BRICs. To account for the cost of loans, I include the corresponding grant element for the BRIC loans obtained. In contrast, model 2 uses the logged loan amount from DACs along with the corresponding lagged dependent variable and grant element. The dependent variable of model 3 are logged IFI loans, while model 4 is estimated with the logged loan amount obtained from private creditors. However, other than the differences in dependent variable, lagged dependent variable and corresponding grant element, the model specification is identical across the four regressions.

The results indicate that Capital coalitions borrow less from BRICs than Corporatist coalitions, while the opposite is the case with private creditors. The same conclusion can be drawn when comparing a Consumer coalition to a Corporatist coalition, as both the magnitude of the coefficients and their statistical significance are remarkably similar.

While the interpretation of marginal effects provides some insights, my theory suggests that the absolute amount of loans obtained from each creditor should vary across coalitions. The quantity of interest is therefore the predicted loan amount that each coalition obtains from the four creditors. I therefore estimate the predicted loan amount by coalition. To facilitate the interpretation of the results I use simulation techniques to visualize the substantive results of interest. This information is displayed in Figure 5.1. The location of each curve's highest point indicates the point prediction of the loan amount that the respective coalition is estimated to obtain on average. The shape of the curve provides information about the certainty of the estimate, with wider curves indicating larger uncertainty.

With respect to the top panel, Corporatist coalitions are estimated to borrow more heavily from BRICs than either Capital or Consumer coalitions. Translating the logarithmic scale into absolute amounts reveals that Corporatist coalitions are estimated to borrow an average of 268 million US\$ per year, while Capital coalitions are expected to obtain about 46 million US\$ and Consumer coalition around 54 million US\$. I test whether these differences are statistically significant by conducting a series of difference-in-means tests¹. The difference between the Corporatist and the Capital coalition yields a χ^2 of 4.85 which implies a p-value of 0.028. The probability that a Capital coalition borrows a larger amount from BRICs than a Corporatist coalition is therefore less than 3%. The t-test for the difference between Corporatist and Consumer coalition is also statistically significant ($\chi^2 = 4.73$, $p = 0.030$). Lastly, the difference between BRIC loans obtained by Capital and Consumer coalition is not statistically significant ($\chi^2 = 0.07$, $p = 0.788$). In short, my theoretical expectations with respect to BRIC loans are confirmed by the data.

DAC loans, however, do not appear to be determined by social coalitions. The second panel indicates that Corporatist coalitions, on average, obtain lower loan amounts from DACs than either Capital or Consumer coalitions. However, these differences are not

¹ I calculate two-tailed difference-in-means tests. While I could achieve statistical significance for additional estimates reported in this section if I were to use one-tailed t-tests, I deem their use inappropriate in this case. After all, I need to account for the possibility that the BRIC loan amount by a Capital coalition is either lower *or* higher than that of the Corporatist coalition.

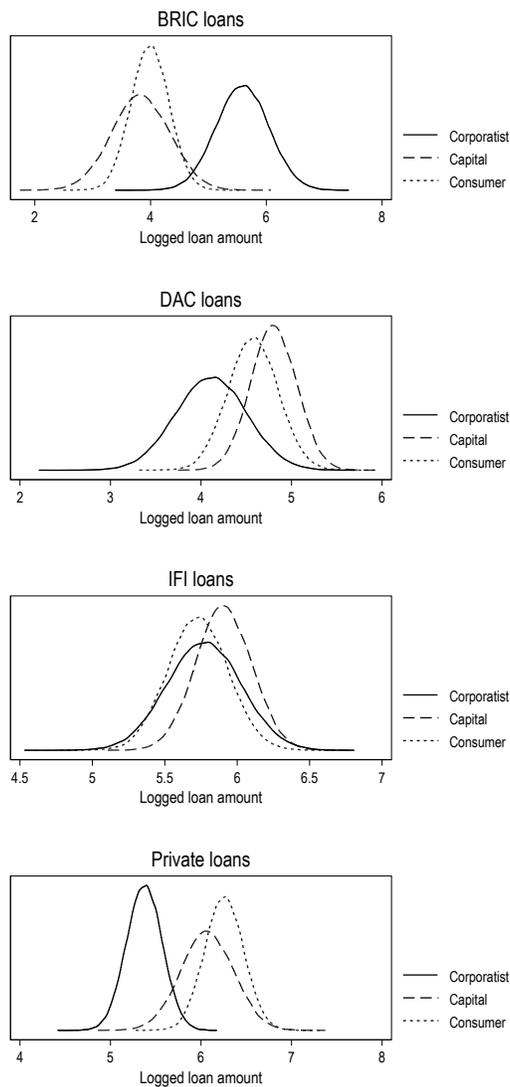


Figure 5.1: Predicted loan amounts by creditor and coalition. Estimates based on Panel OLS Model.

statistically significant, as the difference-in-means test for the Corporatist-Capital pair results in a χ^2 of 2.04 ($p = 0.154$) and that for the difference between Corporatist and Consumer coalition in a χ^2 of 0.74 ($p = 0.389$). The predicted DAC loan amounts for

Consumer and Capital coalition do not differ either ($\chi^2 = 0.39$, $p = 0.534$).

A similar picture is revealed in the degree to which governments obtain loans from IFIs. Neither of the three coalitions appears to obtain significantly larger amounts from IFIs than the respective other coalitions. Difference-in-means tests confirm the estimates displayed in the third panel of Figure 5.1. The difference between Corporatist and Capital coalition is insignificant ($\chi^2 = 0.16$, $p = 0.688$) as is the difference between the Corporatist and Consumer coalition ($\chi^2 = 0.02$, $p = 0.897$) and the Capital and Consumer coalition ($\chi^2 = 0.40$, $p = 0.529$).

In contrast, the predicted loan amount that the three coalitions are expected to obtain from private creditors differ markedly. The bottom panel of Figure 5.1 shows that governments of countries characterized by a Corporatist coalition utilize private creditors less extensively than those characterized by both Capital and Consumer coalition. On average, the model predicts Capital coalitions to obtain 433 million US\$ while Consumer coalitions would borrow 521 million US\$ per year. In contrast, Corporatist coalitions are predicted to borrow only 216 million US\$ per year. The p-value for the difference between Corporatist and Capital coalition is 0.046 ($\chi^2 = 3.97$), and that for the difference between Corporatist and Consumer coalition is 0.005 ($\chi^2 = 7.85$). In contrast, the difference between Capital and Consumer coalition is not statistically significant ($\chi^2 = 0.20$, $p = 0.652$). My theoretical predictions are therefore strongly supported, as Corporatist coalitions obtain significantly fewer resources from private creditors than either Capital or Consumer coalitions.

In sum, the panel estimates presented in this section provide support for the hypotheses derived in Section 2.5. Even when controlling for a host of methodological issues (selection effect, temporal autocorrelation) and alternative explanations, social coalitions appear to determine the choice of creditor. There are significant differences between the Corporatist coalition, which excludes Finance, as compared to either the Capital or the Consumer coalition which both include Finance. While the former tend to favor borrowing from

BRICs, the latter prefer to obtain loans from private creditors. In other words, Capital and Consumer coalition borrow about 10 times as much from private creditors than BRICs per year. In contrast, Corporatist coalitions borrow more from BRICs than private creditors.

5.2.3 Appraisal

Linear panel data models are valuable because they allow for estimating the loan amount that each coalition is expected to acquire. However, recall that my theory suggests an interdependency among creditors. Faced with the constraint of a maximum amount of loans that can be obtained, a government's choice *for* one creditor is simultaneously a choice *against* another. However, the approach with panel data requires me to estimate the predicted loan amount obtained *separately* for each type of creditor. Panel models are therefore inherently unable to account for the interdependencies I derive in Chapter 2. To adequately test my theory, I therefore need to turn to estimation methods that allow for the borrowing decisions of governments among the different creditors to be estimated jointly.

	(1)	(2)	(3)	(4)
	BRICs	DACs	IFIs	Private
Capital coalition	-1.759** (0.799)	0.687 (0.482)	0.134 (0.333)	0.695** (0.349)
Consumer coalition	-1.598** (0.735)	0.461 (0.534)	-0.044 (0.341)	0.881*** (0.314)
intransitive situation	-0.087 (0.557)	0.560 (0.484)	0.039 (0.370)	0.388 (0.325)
L.BRICs	0.353** (0.175)			
Interest rate, BRICs	0.085 (0.326)			
Grace period, BRICs	-0.299* (0.154)			
Maturity, BRICs	0.133** (0.061)			
L.DACs		0.434*** (0.118)		
Interest rate, DACs		0.102 (0.159)		
Grace period, DACs		-0.033 (0.077)		
Maturity, DACs		0.022 (0.040)		
L.IFIs			0.204*** (0.056)	
Interest rate, IFIs			-0.072 (0.071)	
Grace period, IFIs			-0.099 (0.064)	
Maturity, IFIs			-0.006 (0.014)	
L.Private				0.432*** (0.112)
Interest rate, Private				0.314*** (0.060)
Grace period, Private				0.048 (0.038)
Maturity, Private				-0.012 (0.026)
Taiwan recognized	-0.856 (2.073)	-0.150 (0.948)	-0.124 (0.405)	-0.456 (0.497)
Total natural resources rents (% of GDP)	-0.067 (0.047)	-0.007 (0.025)	-0.026* (0.014)	0.009 (0.017)
S-score of G5	-3.215 (2.948)	2.084 (1.295)	0.926 (0.844)	2.538*** (0.837)
I.IMF Membership	(dropped)	(dropped)	(dropped)	(dropped)
Principal arrears, official creditors (US\$)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
Interest arrears, official creditors (US\$)	-0.000 (0.000)	0.000* (0.000)	0.000 (0.000)	0.000 (0.000)
Principal arrears, private creditors (US\$)	-0.000 (0.000)	0.000** (0.000)	-0.000 (0.000)	-0.000 (0.000)
Interest arrears, private creditors (US\$)	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
GDP per capita	-0.535 (0.755)	0.149 (0.286)	-0.006 (0.194)	0.271 (0.306)
Revenue, excluding grants (% of GDP)	0.063 (0.061)	-0.041 (0.035)	0.009 (0.023)	-0.088*** (0.028)
Gov't consumption expenditure (% of GDP)	-0.155* (0.093)	0.005 (0.047)	-0.013 (0.027)	0.087*** (0.028)
Imports of goods and services (% of GDP)	-0.081 (0.069)	-0.010 (0.021)	-0.036*** (0.013)	-0.008 (0.016)
Exports of goods and services (% of GDP)	0.095 (0.061)	0.018 (0.029)	0.005 (0.015)	0.004 (0.014)
External debt stocks (% of GNI)	0.011 (0.024)	-0.006 (0.007)	0.003 (0.003)	-0.008 (.003)
z ₁	0.158 (1.526)	-0.236 (1.098)	-0.636 (0.802)	-0.000 (0.926)
z ₂	1.682 (2.240)	2.241 (1.841)	0.370 (1.106)	1.001 (1.080)
z ₃	0.546 (0.686)	-0.926 (0.615)	0.330 (0.257)	-1.119** (0.458)
z ₄	-4.962e+07 (34619973.900)	-1.896e+07 (24545706.585)	443924.560 (7327629.744)	-4.868e+07 (33640166.470)
Constant	13.012** (5.835)	-1.287 (4.072)	5.708* (3.190)	-3.081 (2.320)
N	49	140	199	179

Standard errors in parenthesis.

* p < 0.10, ** p < 0.05, *** p < 0.01

Table 5.1: Model results of OLS panel regression.

5.3 Multinomial logit model

5.3.1 Model specification

As indicated above, it is questionable whether linear panel data models are appropriate for the question at hand as they are unable to account for the interdependency among creditors. Fortunately, there are alternatives available. For example, instead of conceptualizing the dependent variable as a continuous measure of the loan volume obtained, one could directly analyze the choices for or against a creditor. Multinomial logit models, for instance, use a discrete variable that captures a range of unordered outcomes as the dependent variable to then estimate the predicted probability that a particular outcome is chosen. This class of models is particularly appealing as it considers the available choices jointly. In other words, the decision-makers are assumed to simultaneously face all of the possible choices and then decide to choose one of the possible outcomes.

It appears straightforward to see how this model might be applied to the question at hand. Governments are presented with loan proposals (see Section 3.3) and need to choose among them. It is therefore reasonable to conceptualize the dependent variable as the choice between BRICs, DACs, IFIs and private creditors and to subsequently estimate whether the type of coalition present affects the predicted probability of choosing one over the other type of creditor.

However, the model assumes that each government chooses only one of the available options but not multiple. As there are instances in my data where governments obtain loans from several creditors in a single year, I am forced to transform the dependent variable. I do so by creating a variable that indicates whether the loan from a particular creditor has been the largest loan obtained by a government in a particular year.

More formally, the latent utility approach that is typically used to motivate multinomial logit models can be directly applied to the question at hand. Each government has a utility U_{ij} associated with each choice of creditor j . That utility U_{it} has a stochastic part ϵ_{ij} and

a systematic part μ_i . The latter is assumed to be a function of the variables associated with the respective country, such as the type of coalition dominating the domestic political economy (that is, $\mu_i = X_i\beta_i$). The government then chooses among the alternatives in such a way that maximizes its utility, so that

$$Pr(Y_i = j) = Pr(U_{ij} > U_{i\ell} \forall \ell \in J) \quad (5.2)$$

Assuming a Type I Extreme Value distribution (i.e. a Gumbel distribution) the probability of Equation 5.2 can subsequently be expressed as

$$Pr(Y_i = j) = \frac{\exp(X_i\beta_j)}{\sum_{j=1}^J \exp(X_i\beta_j)} \quad (5.3)$$

5.3.2 Results

The results of these estimations are presented in Table 5.2. To identify Equation 5.3 the research is required to choose a base category against which the other outcomes are compared. I follow the common practice of choosing the most frequent category as the base category, which in my case is the choice for IFI loans. The table therefore does not display results for this choice, even though it was included in the estimation. Note that the coefficients for the included choices are displayed in separate columns for space considerations, but were actually estimated jointly.

However, because of the functional form of multinomial logit estimators, the interpretation of the resulting coefficients is not intuitive. To facilitate the interpretation of the model results I therefore calculate the predicted probabilities across the three coalitions to identify how the type of coalition affects the probability that a loan of a particular creditor is the largest loan obtained in a particular year. Figure 5.2 displays the predicted probabilities that a particular coalition obtained its largest loan from one of the four creditors. As can be seen, the results are not convincing. With the exception of the very low predicted probability that BRIC loans are the largest loan obtained by Consumer coalitions, none of

the remaining predicted probabilities are significantly different across coalitions.

5.3.3 Appraisal

The lack of significant results is not surprising. To be sure, the multinomial logit model appears appropriate for the question at hand at first sight because it accounts for the choice amongst the four creditors jointly. However, the model makes the assumption that each government only chooses *one* of the available creditors – the option that gives it the highest utility. The model cannot accommodate instances in which countries chose to borrow from two or more creditors in the same year. Estimating a multinomial logit model with the loan data available therefore required a transformation of the dependent variable. I addressed this requirement by creating a variable indicating if a government's loan from a particular creditor was the largest loan obtained in a given year.

However, this transformation is highly dubious, for several reasons. First, this transformation loses information on the additional, yet smaller, loans that a country might have obtained in the same year. For example, Table 5.3 shows that only about a quarter of all country-years chose only one creditor. It would be only for this subset of cases that the dependent variable as conceptualized for the multinomial logit model above would be appropriate. For the remaining 75% of cases the dependent variable used would lose the information on one or more loans that were obtained in the same year, but that were smaller than the respective largest loan acquired.

In addition, the transformation of the dependent variable loses information not only with respect to the number of loans considered, but also truncates qualitative information. For example, a discrete measure of loan choice disregards whether the largest loan was 1 billion US\$ or 10 million US\$ as long as either of these two loans are larger than any other loans obtained in that year. Similarly, if two or more loans were acquired, the relative volume of loans is ignored. In other words, it does not matter whether the largest loan was larger by 1 million US\$ or 1 billion US\$. Clearly, however, the details on the size of

the loans, both absolute and relative, are important information. However, in the context of multinomial logit models such information cannot be incorporated into the dependent variable.

Lastly, the transformation of the dependent variable also makes the assumption that all creditors, in principle, have comparable chances of being the largest loan obtained. This might be reasonable for the comparison of government's choice among the traditional creditors. The IFIs, DACs and private creditors have established themselves as creditors to developing countries over a longer period of time. In contrast, BRICs have entered the stage only recently. It is therefore unreasonable to expect that BRICs have the same chance of being the largest loan obtained in a single year as traditional creditors.

	(1) BRICs	(2) DACs	(3) Private
Interest rate, BRICs	1.201*** (0.317)		
Grace period, BRICs	-0.484*** (0.169)		
Maturity, BRICs	-0.200* (0.106)		
Interest rate, DACs		-0.138 (0.186)	
Grace period, DACs		0.095 (0.086)	
Maturity, DACs		-0.103** (0.049)	
Interest rate, Private			1.304*** (0.343)
Grace period, Private			0.774*** (0.158)
Maturity, Private			-1.071*** (0.177)
Capital coalition	1.734 (1.792)	-1.460 (1.121)	2.362 (2.020)
Consumer coalition	-5.700*** (2.113)	-0.603 (1.371)	0.365 (3.777)
intransitive situation	-6.402** (2.923)	-0.727 (1.093)	0.798 (2.510)
Taiwan recognized	-26.506*** (4.512)	0.149 (1.176)	-3.170 (3.739)
Total natural resources rents (% of GDP)	-0.078 (0.060)	-0.062 (0.042)	-0.101 (0.077)
S-score of G5	-23.632** (9.231)	0.609 (2.442)	6.384 (8.191)
IMF Membership	(dropped)	(dropped)	(dropped)
Principal arrears, official creditors (US\$)	0.000* (0.000)	-0.000 (0.000)	-0.000 (0.000)
Interest arrears, official creditors (US\$)	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)
Principal arrears, private creditors (US\$)	-0.000 (0.000)	-0.000 (0.000)	-0.000*** (0.000)
Interest arrears, private creditors (US\$)	-0.000 (0.000)	0.000 (0.000)	0.000*** (0.000)
GDP per capita	-3.862*** (1.374)	-0.866 (0.641)	-1.477 (1.246)
Revenue, excluding grants (% of GDP)	0.058 (0.089)	-0.013 (0.058)	-0.056 (0.103)
Gov't consumption expenditure (% of GDP)	-0.124 (0.129)	0.125 (0.091)	-0.173 (0.230)
Imports of goods and services (% of GDP)	0.011 (0.059)	-0.076* (0.040)	0.002 (0.065)
Exports of goods and services (% of GDP)	0.112 (0.075)	0.159*** (0.054)	0.124* (0.073)
External debt stocks (% of GNI)	-0.067** (0.028)	-0.017 (0.017)	-0.052** (0.024)
Constant	67.381*** (23.339)	4.532 (5.943)	9.744 (22.142)
N	330	330	330

Standard errors in parenthesis.

* p < 0.10, ** p < 0.05, *** p < 0.01

Table 5.2: Model results of Multinomial Logit analysis.

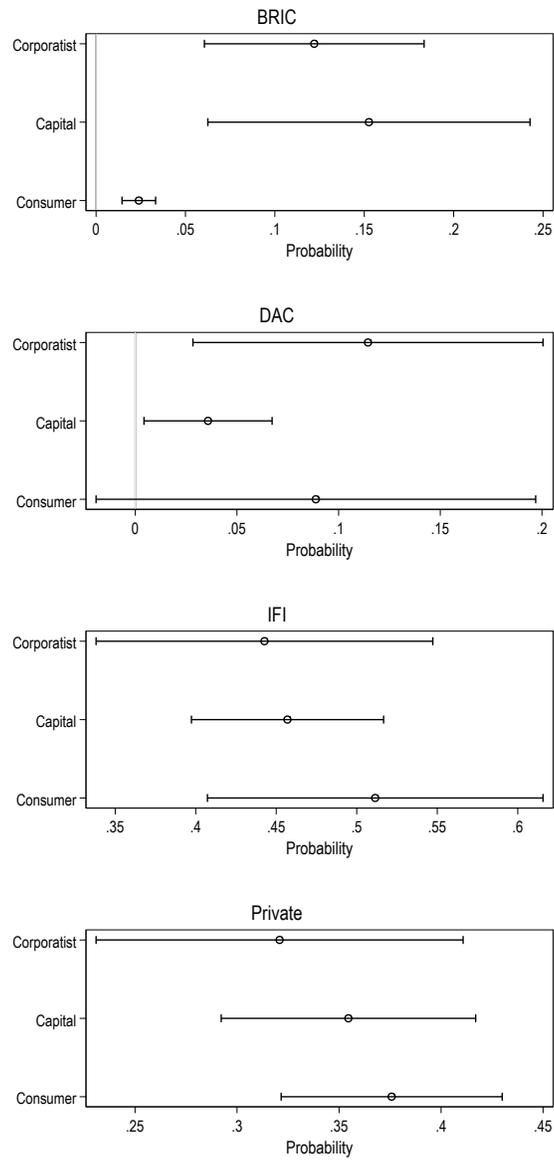


Figure 5.2: Predicted probabilities by coalition that the loan obtained from the respective creditor is the largest of all loans obtained.

	Freq.	Percent
BRIC only	15	1.66
DAC only	5	0.55
IFI only	171	18.94
Private only	56	6.20
BRIC, DAC	10	1.11
BRIC, IFI	80	8.86
BRIC, Private	20	2.21
DAC, IFI	68	7.53
DAC, Private	18	1.99
IFI, Private	95	10.52
BRIC, DAC, IFI	38	4.21
BRIC, DAC, Private	5	0.55
BRIC, IFI, Private	37	4.10
DAC, IFI, Private	138	15.28
all creditors	87	9.63
no loan	60	6.64
Total	903	100

Table 5.3: Frequency and distribution of creditor set chosen by all governments.

5.4 Differentiated Product Model

5.4.1 Model specification

Methodological issues of the multinomial logit model

The multinomial logit model has a number of additional drawbacks, beyond issues with the dependent variable identified above. For example, it assumes that we observe all characteristics of the loans offered. In other words, the model used in Section 5.3 does not allow for unobserved project characteristics. However, we do not have data on the conditions of individual loans. Rather, I have assumed that loans from BRICs have specific characteristics, namely that they are attached to particular investment projects. In contrast, IFI loans are thought of possessing characteristics that link them to fiscally conservative macroeconomic outcomes. In sum, I have used rather crude classifications to characterize differences across loans. An ideal estimation method should relax this assumption to allow for product characteristics ξ_i that are observed by government entities but not reflected in the data available to researchers.

Second, the multinomial logit model implicitly assumes that the decision among competing goods is made by a homogenous entity. In Political Science this has led to the application of such models to the estimation of voting behavior by individual citizens (Whitten and Palmer, 1996). Accordingly, I have implicitly assumed that the amount borrowed from a country in a particular year was borrowed by a homogenous entity.

However, recall that the data I obtained from the World Bank only reports the total amount that a country obtained from a particular creditor in a specific year. I do not have information on the number of loans that were obtained nor information on which government entity has obtained the loan. It is, however, entirely reasonable to assume that the total volume of loans obtained consists of the sum of individual loan agreements reached by individual government entities. In fact, my fieldwork indeed suggests that this is the case (see Section 3.3). After all, infrastructure is financed by the transportation

ministry while the finance ministry obtains loans to supplement the general budget.

This has important implications, as it allows me to view the loan data as aggregate market data. In other words, each country-year is more accurately described as its own market where individual government entities have made discrete choices for or against specific loan proposals. Aggregating these borrowing decisions results in a total obtained

$$N, (q_j, p_j, x_j) : j = 1, 2, \dots, J \quad (5.4)$$

where N is the number of government entities in a country with the ability to borrow, q_j is the aggregated quantity of the loans obtained from creditor J , while p_j stands for the price of the loan by creditor J . x_i, \dots, x_j represents the vector of characteristics of the respective loans. In my case, $J = 4$ which allows me to construct the market shares for each creditor.

Instead of conceptualizing loans as completely independent of each other (as I did in Section 5.2) or considering the loan data only in a very truncated form (see Section 5.3) I can now focus on the *composition* of the total debt obtained. In other words, I will focus on explaining the respective *share* of loans that the government in total (i.e. the sum of loans obtained by its individual entities) will acquire.

Most importantly, though, conceptualizing the dependent variable in this manner allows me to account for the decision to not borrow in the first place. In other words, I can define the outside good as

$$s_0 = 1 - \sum \frac{q_j}{N} \quad (5.5)$$

Following the theory outlined in Chapter 2 I assume that the debt portfolio composition of a Corporatist coalition will differ from that of a Capital or Consumer coalition. Namely, the former is expected to rely more heavily on BRICs as the source of loans while discounting the importance of IFIs. In contrast, Capital coalitions are assumed, on average, to favor IFIs and private creditors in the composition of their debt portfolio. Consumer coalitions

are also expected to favor traditional creditors, primarily DACs.

The model

In sum, the multinomial logit model is inappropriate as it truncates the dependent variable, ignores unobserved heterogeneity, and assumes individual-level data which I do not have. Fortunately, Berry (1994) proposes a model explaining the demand for differentiated products that avoids these issues. In what follows I will introduce this model and modify it for my purposes.

I begin by assuming that the utility a government entity i obtains from not acquiring a loan is zero.

$$U_{i0} = 0 \tag{5.6}$$

This is a reasonable assumption in the context of my theory, as I assume politicians running the government entities have the incentive to cater to the dominant societal interest groups in order to secure their re-election. Not borrowing, and thereby depriving the dominant interest group of the expected positive distributional consequences that such a loan would have, would therefore not gain the politician anything. Consequently, the politician's utility obtained from obtaining the loan j is given by

$$\begin{aligned} U_{ij} &= x_j\beta - \alpha p_j + \xi_j + \epsilon_{ij} \\ &= \delta_j + \epsilon_{ij} \end{aligned} \tag{5.7}$$

where δ_j is the mean utility for loan j that is common across all government entities i . ϵ_{ij} is a characteristic of product j that is unobserved by the researcher but observed by both creditors and borrowers. If we make the logit assumption that $\epsilon_{ij} \sim iid$ across government entities i and creditors j we can define choice indicators y_{ij} that equal 1 if i chooses loan j and 0 otherwise. Given these assumptions, the choice probabilities on the level of the individual government entity i take the multinomial logit form

$$Pr(y_{ij} = 1 | \beta, x_{j'}, \xi_{j'}, j' = 1, \dots, J) = \frac{\exp(\delta_j)}{\sum_{j'=0}^J \exp(\delta_{j'})} \quad (5.8)$$

On the aggregate level for each country-year, however, the subsequent aggregate market shares for loan j arising from the individual government entity decisions are as follows:

$$s_j = \frac{\exp(\delta_j)}{\sum_{j'=1}^J \exp(\delta_{j'})} \quad (5.9)$$

which is equal to

$$s_j = \frac{\exp(x'_j \beta - \alpha p_j + \xi_j)}{1 + \sum_{I=1}^J \exp(x'_I \beta - \alpha p_I + \xi_I)} \quad (5.10)$$

The analogous exercise yields the following market share for the outside good, i.e. for the option of not borrowing in the first place.

$$s_0 = \frac{1}{1 + \sum_{I=1}^J \exp(x'_I \beta - \alpha p_I + \xi_I)} \quad (5.11)$$

The data

Before estimating the model, I need to transform my data to fit this structural form. I therefore convert the data on the aggregate loan amount obtained in a country-year by creditor j into shares of that loan in comparison to the total market size M . In the context of my theory, the M indicates the amount of debt that a country could possibly obtain. In other words, I need a measure of the ‘room to borrow’ available to a country in a particular year. This involves a modeling assumption, as there is no direct way to infer a maximum debt limit and calculate the subsequent room to borrow. To derive the total market size M , I therefore follow the standard approach of expressing the overall indebtedness of a country as a ratio between the total external debt stock and the country’s GDP. I then identify the country with the highest ratio in my dataset, which is Liberia in 2005 with a ratio of Liberia 2.175. It therefore appears to be the empirical reality that countries

are theoretically able to borrow up to about 2.2 times their GDP. Using this ratio I then calculate the corresponding maximum absolute amount of external debt that a country theoretically could obtain. I subsequently subtract the already existing amount of debt to arrive at an estimate of the market size M (i.e. the ‘room to borrow’) of a particular country-year. Incidentally, this method of calculating the ‘room to borrow’ should alleviate concerns about serial correlation. Loans obtained at time t become part of the debt stock at time $t + 1$ which is subsequently subtracted from the theoretical debt limit. Thus, the calculation of M_{t+1} incorporates the amount of debt obtained in the previous year, accounting for the effect that it might have on the capacity for renewed borrowing at time $t + 1$.

Having estimated M , I can calculate the market shares for each creditor j with

$$s_j = \frac{a_j}{M} \quad (5.12)$$

where a_j is the absolute loan amount obtained from creditor j in a particular country-year.

To obtain the market share of the outside option is straightforward with

$$s_0 = \frac{M - \sum_{j=1}^4 a_j}{M} \quad (5.13)$$

The estimation

The data therefore contains the observed shares $\tilde{s}_j = 1, \dots, J$ that together with the parameters identified in the model allow for the estimation of the predicted shares $\hat{s}_j(\alpha, \beta, \xi_1, \dots, \xi_J), j = 1, \dots, J$. The idea of the model is to estimate the parameters α and β by finding those values which ‘match’ the observed shares to the predicted shares. More formally, the model seeks to find α and β so that $\hat{s}_j(\alpha, \beta)$ is as close to \tilde{s}_j as possible for $j = 1, \dots, J$.

This is a rather difficult challenge. Assuming that there exist instruments Z , so that $E(\xi Z) = 0$, the sample analog of this moment condition is

$$\begin{aligned}
\ln(\tilde{s}_0) &= 0 - \ln(1 + \sum_{j=1}^J \exp(\delta_j)) \\
\ln(\tilde{s}_{BRIC}) &= \delta_{BRIC} - \ln(1 + \sum_{j=1}^J \exp(\delta_j)) \\
\ln(\tilde{s}_{DAC}) &= \delta_{DAC} - \ln(1 + \sum_{j=1}^J \exp(\delta_j)) \\
\ln(\tilde{s}_{IFI}) &= \delta_{IFI} - \ln(1 + \sum_{j=1}^J \exp(\delta_j)) \\
\ln(\tilde{s}_{PRI}) &= \delta_{PRI} - \ln(1 + \sum_{j=1}^J \exp(\delta_j))
\end{aligned} \tag{5.18}$$

This results in

$$\delta_j = \ln(\tilde{s}_j) - \ln(\tilde{s}_0), j = 1, \dots, J. \tag{5.19}$$

Following Berry's second step, I can then run a so-called logistic regression of the following form:

$$(\ln s_j - \ln s_0) = X_j \beta - \alpha p_j + \xi_j + \epsilon \tag{5.20}$$

5.4.2 Results

After calculating the market sizes along the lines of Section 5.4.1 I subsequently transform the data to create the dependent variable required by Equation 5.20. I then estimate the model with the same set of control variables that were used in the previous models to ensure comparability. The model results are presented in Table 5.4.

However, to facilitate the interpretation of the model results, I draw on one of the major advantages of a Differentiated Product Model. As it is based on data representing the share of loans obtained from a specific creditor in comparison to the overall amount of loans obtained in a particular year, the results can be presented in the same manner. In other words, the model allows for the calculation of the predicted mix of creditors that a country, conditional on its characteristics, will obtain in a given year. For this reason, I first recover s_{ji} for each type of coalition c across the four types of creditors j using

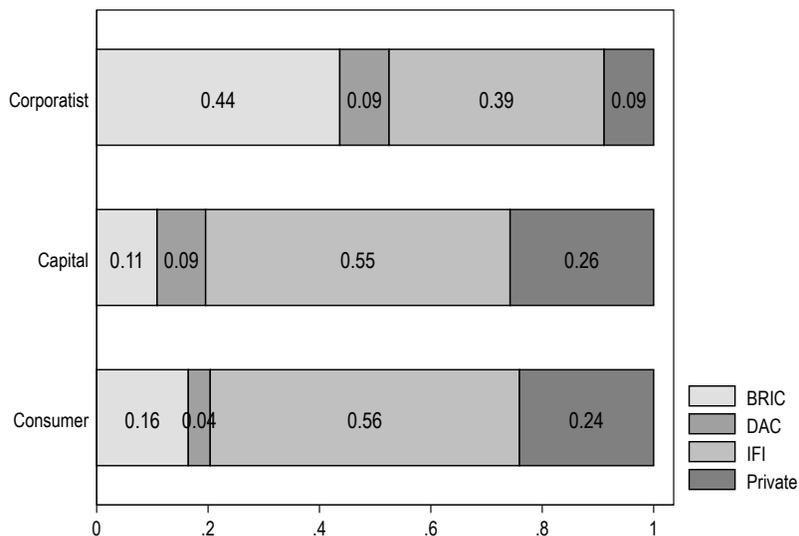


Figure 5.3: Predicted loan shares by coalition based on Differentiated Product Model.

$$s_{jc} = \frac{\exp(x'_{jc}\beta)}{1 + \sum_j^4 \exp(x'_j\beta)} \quad (5.21)$$

However, because Berry's model requires the market size M to be arbitrarily large, the resulting shares by creditor-coalition combination are unreasonably small in comparison to the option of not choosing a loan, s_0 . As I am primarily interested in the relative loan shares of the four creditors, I will focus the information the model provides on these parameters. I therefore omit s_0 to facilitate the representation of differences across s_{jc} . This is possible because s_0 does not differ significantly across coalitions. Figure 5.3 therefore displays the share of obtained

There are clear differences in the mix of creditors used by the various coalitions. In particular, the differences between the Corporatist coalition and both the Capital and Consumer coalition are striking. In each country-year, government entities in countries characterized by a Corporatist coalition acquire 44% of the total loan amount obtained in

that year from BRICs. In contrast, government agencies in countries with either Capital coalitions or Consumer coalitions utilize BRIC creditors to a much lesser extent, borrowing only 11% or 16% on average and are relying more heavily on IFIs and private creditors. With respect to the IMF, governments facing Capital and Consumer coalitions obtain more than half of their annual borrowing amount from IFIs (55% and 56%, respectively). While Corporatist coalitions are predicted to still obtain a sizable amount from IFIs, with 39% of the overall borrowing amount its share is about 30% smaller than that of the other coalitions. Lastly, Corporatist coalitions utilize private creditors to a minimal degree as only 9% of their annual total loan amount obtained comes from this source. In contrast, both Capital and Consumer coalition borrow almost three times as much from private creditors. The former obtains 26% of the annually borrowed amount from private creditors, while the figure stands at 24% for the Consumer coalition.

Figure 5.4 focuses on the differences across coalitions as compared to a hypothetical average country that obtains the mean share of loans from the four creditors as observed in the entire sample. The three panels then display the percent deviations from the mean of the loan shares acquired by each of the coalitions. In comparison to an average country, Corporatist coalitions obtain a much larger share of the total volume of loans obtained annually from BRICs, while Capital and Consumer coalitions underutilize this creditor. In this respect, the differences across coalitions are remarkable. In contrast, there do not appear to be significant differences in the degree to which the three coalitions utilize DAC creditors. While Corporatist coalitions rely heavily on BRIC creditors, the opposite is true with respect to both IFIs and private creditors. In comparison to an average country, the predicted loan share of IFIs and private creditors is about 11% below average, while both Capital and Corporatist coalitions utilize these creditors to a higher degree than an average country.

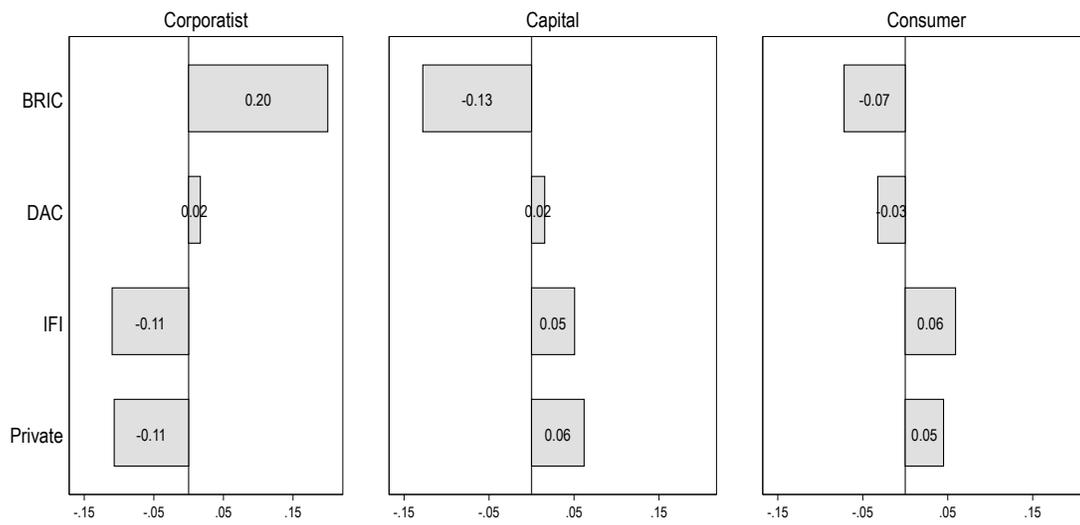


Figure 5.4: The difference in predicted loan share for each coalition in comparison to loan share obtained by an average country.

	$\ln s_j - \ln s_0$
BRIC loan & Corporatist coalition	0.692* (0.354)
BRIC loan & Capital coalition	-0.020 (0.470)
BRIC loan & Consumer coalition	-0.135 (0.278)
DAC loan & Corporatist coalition	-0.469* (0.269)
DAC loan & Capital coalition	-0.572** (0.287)
DAC loan & Consumer coalition	-0.603** (0.267)
IFI loan & Corporatist coalition	0.946*** (0.286)
IFI loan & Capital coalition	1.006*** (0.241)
IFI loan & Consumer coalition	1.701*** (0.242)
Private loan & Corporatist coalition	-0.249 (0.270)
Private loan & Capital coalition	0.497* (0.263)
Private loan & Consumer coalition	0.909*** (0.267)
Interest rate	0.248*** (0.033)
Grace period	0.068*** (0.017)
Maturity	0.031*** (0.009)
Taiwan recognized	-0.121 (0.233)
Total natural resources rents (% of GDP)	-0.015 (0.009)
S-score of G5	1.412*** (0.431)
IMF Membership	(dropped)
Principal arrears, official creditors (US\$)	0.000 (0.000)
Interest arrears, official creditors (US\$)	-0.000** (0.000)
Principal arrears, private creditors (US\$)	0.000** (0.000)
Interest arrears, private creditors (US\$)	-0.000** (0.000)
GDP per capita	-0.093 (0.094)
Revenue, excluding grants (% of GDP)	-0.039*** (0.012)
Gov't consumption expenditure (% of GDP)	0.073*** (0.018)
Imports of goods and services (% of GDP)	0.004 (0.007)
Exports of goods and services (% of GDP)	0.014* (0.008)
External debt stocks (% of GNI)	0.007*** (0.002)
Constant	-24.463*** (1.038)
N	840

Standard errors in parenthesis.
* p < 0.10, ** p < 0.05, *** p < 0.01

Table 5.4: Model results of Differentiated Product Estimation.

5.5 Summary of findings

The methodological advantages of the Differentiated Product Model over alternative approaches are compelling. Unlike linear panel data models, it allows estimating the demand for all four types of creditors simultaneously, instead of in separate regressions. In contrast to multinomial logit models, it makes full use of all available data on borrowing patterns across countries and makes more appropriate assumptions about the data-generating process. The model explicitly incorporates the ‘room to borrow’ that a country has available. Unlike other estimators, the Differentiated Product Model can therefore elegantly account for the interdependency among creditors. As derived from my theory, a maximum amount of debt that can be obtained implies that a country’s decision *for* one creditor is simultaneously a decision *against* another. This further allows the model to explicitly account for the choice by governments to not borrow at all. Lastly, the results of this estimator allow for the calculation of the degree to which countries utilize particular creditors. In other words, it provides a consistent and efficient way to predict the *composition* of the total amount of loans obtained per year conditional on country characteristics. In contrast, existing scholarship on sovereign borrowing has only focused on explaining the choice for or against a single creditor while disregarding simultaneous borrowing from other sources. The estimation method proposed here thus represents a significant methodological contribution to the study of sovereign debt as it focuses on the overall composition of loans acquired.

The substantive results obtained from the Differentiated Product Model provide strong support for the argument that social coalitions matter when governments decide among creditors. In particular, the mix of creditors used in a given country-year differs remarkably between the Corporatist coalition and both the Capital and Consumer coalition. As predicted by my theory, Corporatist coalitions provide governments with the incentive to favor BRIC creditors while utilizing IFIs and private creditors less heavily. Further, both Capital and Consumer coalitions were predicted to discount BRIC loan offers and instead

primarily use traditional creditors.

Even though the theoretical predictions made in Chapter 2 are largely confirmed, the similarity between the composition of new loans obtained by Capital and Consumer coalition is striking. While I had predicted both coalitions to favor traditional creditors over BRICs, I had expected differences in the degree to which they would utilize DACs, IFIs, and private creditors. The fact that the predicted composition of borrowing does not differ significantly among Capital and Consumer coalitions might point to the relative importance of Finance in the political arena. Recall that the Corporatist coalition is the only coalition that excludes Finance, while both the Capital coalition between Industry and Finance as well as the Consumer coalition with Finance and Labor include this actor. Future work might therefore focus on the difference between social coalitions that include Finance versus coalitions that exclude Finance. While the theoretical emphasis on societal coalitions is confirmed, it might be the case that a more parsimonious model of societal coalitions has just as much empirical traction as the more sophisticated model presented in Chapter 2.

Chapter 6

Qualitative Evidence on Coalition Formation and Loan Choice

In 2011, I conducted fieldwork in Ecuador, Peru and Colombia in order to complement the statistical analysis presented in the previous chapters with qualitative evidence. Previous sections have already drawn heavily on the qualitative insights gained in the field. For example, in Section 3.7 I have recapitulated the statements made by interviewees of Labor, Industry and Finance to show that their preferences across creditors differ systematically. Similarly, my theory of informal coalition formation presented in Section 4.3 was inspired by my conversations with politicians in Ecuador, Peru and Colombia.

So far, however, I have drawn on my fieldwork primarily in order to show how individual actors – either the societal actors Labor, Industry and Finance, or the politicians responding to these societal actors – have exhibited consistent behavior across these countries. In contrast, this chapter will focus on the fact that the configuration of these actors differs across the three countries, which results in each country being characterized by different informal coalitions. This chapter will therefore focus on the political dynamics that led to the emergence of particular coalitions. I will argue that for the time frame under consideration, 2004 - 2010, Ecuador can be characterized as a Corporatist coalition, Colombia as

a Capital coalition, and a Consumer coalition as dominant in Peru. I then trace how the presence of these particular coalitions influenced the respective governments' borrowing decisions.

6.1 Methodological approach

6.1.1 Case selection

My case selection was guided by theoretical considerations derived from my conceptual framework. In doing so, I followed the advice of King, Keohane and Verba (1994, p.19) to focus on the observable implications of my theory that need to be verified. I therefore selected cases that allow for counterfactual analysis. This is essential, as it offers the possibility to assess causality by comparing the outcome of the “treatment” to the “control” case (King, Keohane and Verba, 1994, p.78). I therefore avoided selecting on the dependent variable and did not focus on the most dramatic examples of BRIC lending (i.e. the loans to Angola). Instead I looked for countries that exhibit variation on the independent variable that my theory suggests to be important.

With these considerations in mind, I selected Colombia, Peru and Ecuador as my cases. Secondary literature suggests that the relative strength of domestic interest groups differs significantly across the three countries. Colombia is characterized by an absence of civil society representation, particularly labor or social movements. This is partly due to the context of ongoing war, where progressive groups were labeled to be part of terrorist groups which prevented an institutionalized movement of labor and civil society. However, it is also partly due to the political landscape being dominated by two strong parties representing the interests of the domestic elite. In contrast, the popular sector in Ecuador is considered strong in comparison to those of capital owners. Since the mid-1990s, social movements, such as the indigenous movement, environmentalist groups, and labor groups, became a visible presence in Ecuadorian domestic politics. They have demanded a stronger voice in

the political process ever since. Lastly, Peru's experience falls somewhere between these two extremes. While labor and other groups were repressed during the Fujimori regime, the liberal policies implemented were consistent with the existing strong interests of Finance and Industry. Yet, Labor has not necessarily resisted this neoliberal agenda since Fujimori's demise.

While these countries differ markedly in the relative influence of various domestic interest groups, they share characteristics in political systems, natural resource endowments, and distance from China. These *ceteris paribus* conditions therefore allow me to control for several alternative explanatory variables and focus on examining the explanatory power of the hypothesized independent variables. In the search for additional analytical traction, I was faced with the question concerning the number of cases I should include. To test each of the hypotheses proposed in Section 2.5, I would have to conduct fieldwork in six countries. However, as this was not feasible with the resources available, I chose to select cases that varied with respect to their coalitional set up, but not the ratio between the required winning coalition and the size of the selectorate, W/S (Bueno de Mesquita et al., 2005). Holding W/S constant allows me to test the coalitional mechanism proposed in Section 2.4. This decision comes with the cost that the qualitative evidence collected will not be able to verify the theoretical mechanisms suggested in Section 3.2. However, I will test this mechanism in Chapter 5 when conducting the large-n statistical analysis on a set of countries that does vary with respect to W/S . Nevertheless, I will present qualitative evidence collected in the field to substantiate the claim that W/S is indeed constant across the three cases Ecuador, Peru and Colombia.

The final considerations with respect to the case selection concern the number of creditors and the time span. I chose to focus on loans from China only as opposed to all BRIC countries. As figures 1.1 and 1.3 indicate, both the lending volume and distribution is largest with respect to the Chinese as compared to Brazil, Russia and India. I therefore focus on Chinese loans, as it is most reasonable to assume that the Chinese might have

potentially offered loans of substantial size to either Ecuador, Peru or Colombia. Also, since BRIC loans of considerable size are a relatively recent phenomenon as evidence by Table 1.2, I focused on the time period of 2005 through 2011.

I will not pretend that the guidance provided by my theory in the process of selecting cases was ideal in every respect. Undoubtedly, the theory presented in Chapter 2 has been informed by my experiences in the field, just as my fieldwork was shaped by my theoretical expectations. In fact, the following quote by King, Keohane and Verba (1994) captures the essence of this interaction:

We need not have a complete theory before collecting data nor must our theory remain fixed throughout. Theory and data interact. As with the chicken and the egg, some theory is always necessary before data collection and some data are required before any theorizing. Textbooks on research teach us that we use our data to test our theories. But learning from the data may be as important a goal as evaluating prior theories and hypotheses. Such learning involves reorganizing our data into observable implications of the new theory. This reorganizing is very common early in many research processes, usually after some preliminary data have been collected; after the reorganization, data collection then continues in order to evaluate the new theory. (King, Keohane and Verba, 1994, p.56).

6.1.2 Identifying interviewees

To test my theory with qualitative methods, I needed to interview decision-makers within the government, representatives of societal groups such as Labor, Finance and Industry, and spokespersons for the various creditors. In short, I needed to conduct elite interviews as my subject group consists of public officials, members of parliament, and leaders of business associations.

The reasons for selecting these types of interviewees are straightforward. First, interviews with representatives of the domestic public sector (Prime Ministers, Finance Ministers, Senators, as well as officials working in Public Debt departments) would allow me to verify whether governmental decision-makers are taking domestic interest groups into account when deciding between creditors. Second, I also needed to interview a broad range of actors in the domestic private sector such as domestic banks, business associations, or labor and civil society representatives. These conversations would allow me to substantiate the theoretical expectation regarding the distributional consequences: I needed to confirm whether each type of actor – Finance, Industry or Labor – indeed expected to benefit from a particular type of loan. Lastly, besides the relevant domestic actors, I needed to interview the various creditors, particularly officials of multilateral institutions and western development agencies as well as Chinese officials, both from the public sector (Chinese Development Bank, Chinese embassies) and the ‘private’ sector (Chinese banks, Chinese mining companies). Interviews with these actors would allow me to verify if the different creditors were indeed in competition, and if domestic considerations of recipient countries are a genuinely overlooked determinant of lending patterns.

6.1.3 Recruitment process

Gaining access to elites presents a particular challenge. Traditionally, obtaining interviews with non-elites is understood as requiring sympathetic understanding towards the subject. For instance, Taylor and Bogdan (1998) suggest that interviewers should be attentive to their ‘superior’ position in society relative to that of the typical subject, and therefore should pay attention to not be perceived as patronizing. In contrast, elite interviews present a different challenge as “the issue is rather a matter of proving one’s professional credentials and standing. Researchers must demonstrate they are worthy of the time and support of busy and often powerful individuals” (Welch et al., 2002, p.612). In other words, researchers only “get in and get useful data from them if [the researchers] know others that

[elites] know and respect.” (Ostrander, 1993, p.12)

In order to be perceived as a credible interviewer, I followed the advice of Peabody et al. (1990) and Richards (1996) and obtained institutional affiliations in each country. For example, I was affiliated with the Universidad de los Andes in Bogota, Colombia. In Peru I worked with the Centro de Investigaci3n at the Universidad del Pac3fico in Lima, and in Ecuador with the Universidad de San Francisco in Quito. These affiliations were invaluable as they provided me with initial contacts to public and private actors. In addition, several former high-level officials were on staff at these institutions, providing a good starting point for subsequent ‘snowballing’ that allowed me to expand the set of interviewees beyond my initial connections. Lastly, I also cold-contacted potential interviewees whose contact information I had obtained from United Nations and IMF conference attendance lists or the respective institutions websites. Because some individuals refused requests for interviews, it was impossible to obtain a random sample – a common challenge for elite interviews given the small population from which to draw (Richards, 1996)¹ . This was exacerbated by the fact that much of the recruitment was based on personal connections that I made while in the field. In the words of [p. 2136]McDowell (1998) “it is impossible to know whether some people refused to speak to me because of antipathy or competition, perhaps, between them and my sponsors.”

However, contrary to the assessment regarding the prospects of gaining access to elites by Aberbach and Rockman (2002, p. 673), I had little difficulty obtaining interviews. Instead, my experience confirms the reports by (Ostrander, 1993) and (Delaney, 2007) that the difficulties of gaining access to elites have been exaggerated. A list of all interview partners is available in the Appendix A.1.

¹ It is even more crucial, therefore, that I test the generalizability of my qualitative findings using large-n statistical analyses in Chapters 4 and 5

6.1.4 Interview setting

The vast majority of interviews were conducted face-to-face at the workplace of the interviewee, while a handful of interviews were done over the phone. Meeting elites at their office introduces a particular sensitivity with respect to the power dynamics between interviewee and interviewer. In non-elite settings, the interviewer is assumed to be the one with higher status (Taylor and Bogdan, 1998, p.111). However, the issue may be different when interviewing elites. In addition, as elites are typically accustomed to public speaking, whether on behalf of their organizations or themselves, it is common that elite interviewees dominate the interview. They are “used to addressing a wide range of audiences and developing elaborate and persuasive arguments; they are used to taking command and being deferred to; and they are confident that their opinions are deserving of attention and respect” (Welch et al., 2002, p.612). Because of this imbalance, scholars suggest that researchers might risk “overestimating the importance of what elites have to say, assuming, for example, that they necessarily know more and better what is going on in an organization” (Ostrander, 1993, p.19). Researchers may therefore attribute causality to elites where none in fact existed (Welch et al., 2002).

This is a serious issue of which I was aware while in the field. But what to do about it? I opted for the following approach: If I would have conceptualized the relationship between the elite-subject running the interview and myself as competitive I would have been forced to ‘fight back’ in order to re-seize control. However, rather than understanding the process of interviewing as an aggressive battle for control, I treated this experience as an opportunity for learning itself. This approach is best captured by Delaney:

I accept the fact that the interviewee will act as a spokesperson, may treat me as status subordinate, and may try to control the interview. Given these tendencies, how can I best gain what I need from the interview? [...] I have no problem assuming the role of someone who needs to learn something (after all, that is the essence of interviewing). In fact, being a status subordinate’ can be

turned to an advantage in that it allows you to say in a very non-threatening way, ‘I don’t really understand that, can you explain ...’ Delaney (2007, p.215)

In addition, the research design mediated this threat insofar as I was pressed to talk to a variety of elites in different positions – Finance, Industry, Labor, domestic government and foreign creditors. This multitude of sources allowed me to triangulate information obtained from a single elite-subject, as recommended by Berry (2002). In addition, observing official arguments made by the subjects allowed me to gain insights into the process of preference aggregation that my theory suggests. While some scholars have cautioned that the responses by elites might leave researcher disappointed, as subjects might assume the role of a ‘spokesperson’ (Ostrander, 1993) for their organization or institution, this would only be a problem if I were interested in the feelings and interpretations of the interviewee. However, my theory suggests that the leaders of societal interest groups should act on behalf of their constituencies, so the ‘spokesperson’ concern did not echo with my experiences in the field. In fact, I was surprised by the frankness of many responses. This corresponds to Sinclair and Brady (1987), who observed that the level of frankness was directly related to the interviewee’s seniority: The higher in the hierarchy, the more candid the statements. As you will see below, I had similar experiences.

6.1.5 Interview consent

In contrast to the United States, the notion of danger and prevention of human subject research has developed differently in South America. In the countries included in this case study, the equivalents to the Internal Review Board (IRB) of the University of Minnesota only deal with medical research. Therefore, the requirements of IRB (such as a consent forms) are rather unfamiliar research practices for both researchers and research subjects in South American settings. In addition, written consent poses cultural problems as it is regarded as a breach of trust between the interviewer and interviewee. Therefore, instead

of written consent forms, I used an oral explanation of the consent process. First, I gave interviewees my contact information as well as general information of my research project. Then I asked four items before starting the interview: (1) whether their participation was voluntary, (2) whether they gave their verbal consent, (3) whether they wanted to remain anonymous, and (4) whether they allowed me to use a voice recorder. Nevertheless, I had prepared consent forms in both English and Spanish in case an interviewee would want a hardcopy of my verbal explanations, or preferred written consent over verbal consent. These consent forms are available in Appendix A.3.

6.1.6 Interview method

I used a semi-structured, open-ended interview method. While structured interviews ask the list of questions in exactly the same order with most questions only allowing a closed response, semi-structured interviews give the subject the opportunity to expand on questions in whichever way they see fit, while keeping the set of questions consistent across interviewees (Huit and Peabody, 1969, p.28). While this approach compromises the direct comparability of interviews as the order of questions may differ, I agree with Aberbach and Rockman (2002) that the advantages of the conversational depth of the responses outweigh the disadvantages of inconsistent ordering. After all, an open-ended approach gives interviewees the opportunity to organize their answers within their own frameworks and thus increases response validity. In addition, as eluded to above, elites are typically confident speakers that are accustomed to dominating discourse. As such, they “do not like being put in the straight-jacket of closed-ended questions” (Aberbach and Rockman, 2002, p.674).

The process by which I arrived at the set of questions was also shaped by the particularities of elite interviews. Since the number of questions that can be asked is generally limited considering the amount of time available with elites, I generally proceeded by asking the most important questions first. In addition, I started with the factual questions in

order to move to the more judgmental-oriented queries later on. I also ran pilot interviews with Colombian academics to test the time it took to administer the interview, and to experiment with different question wording and ordering (see Peabody et al., 1990). By the end of this process I arrived at three sets of interview questions for each subject type I intended to interview: Government officials of the recipient country, representatives of the domestic interest groups (i.e. Finance, Industry, and Labor), and representatives of external creditors. The sets of questions that guided my interviews are available in Appendix A.2.

In terms of formalities, I asked each interviewee at the beginning of our conversation if he or she wanted to conduct the interview in English or Spanish. Most of the time, English was preferred as it is the professional language of elites. Before asking the first substantive questions, I stressed that the interview was for academic purposes only to alleviate any trust issues. In addition, I shared my background as a student, a German citizen, who was educated in the UK, studying in the US, and a researcher interviewing in Latin America about China, which revealed that I did not have any business interests, but was genuinely interested in the topic as an academic pursuit.

In sum, therefore, the methodological approach to testing my theory with qualitative methods is characterized by a case selection guided by the independent variables proposed in the theoretical framework. In addition, careful attention was given to the particularities of elite interviews with respect to the process of identifying, recruiting and interviewing elite-subjects.

6.2 Ecuador - a Corporatist coalition

6.2.1 Correa exploiting existing sentiments

Much anecdotal evidence exists indicating that politicians conduct polls to maximize the appeal of their message to voters. During my fieldwork, I encountered that this observation

holds for politicians in developing countries as well. In the context of Ecuador, for example, one member of the constitutional assembly told me that Correa's staff did several surveys prior to the start of his first campaign in 2005 to learn more about the concerns of different segments in society (Paredes, 2011).

The existing sentiments dominating societal discourse were characterized by a strong antipathy to IMF loans. A former finance minister told me that following the financial crisis in 1999 Labor and Industry were under the impression that IMF policies undermined the productive capacity of Ecuador. The conditions of the IMF program were thought of as contributing to developments that left 3 million businesses bankrupt, and the emigration of 20% of the productive population (Salgado, 2011). The interviewee was therefore not surprised that political movements demanding employment and investment instead of austerity measures sprung up against IMF policies. The preferences of Labor and Industry were openly revealed: Labor was less concerned with inflation, but more interested in increasing the levels of domestic investment to create employment opportunities. Industry was tired of austerity measures that undermined efforts to increase public investment. Interestingly, virtually all observers concurred that these sentiments were present in the population prior to Correa's campaign, as evidenced by interviews with a Central Banker (Anonymous, 2011*b*), a former Finance Minister (Salgado, 2011), a director of a conservative think tank (Albornoz, 2011), and an academic (Jácome Estrella, 2011). In fact, observers note that Correa capitalized on these sentiments by aligning his campaign with the preferences of Labor and Industry.

This sentiment against multilateral creditors was complemented by aversion to private debt. In Ecuador's recent past, various debt rollovers were managed so poorly that observers were certain of corruption (Rast, 2011). This impression was heightened when videotapes were leaked in February 2007 showing Ecuador's Minister of the Treasury Ricardo Patiño and his advisor, Héctor Égüez, meeting with two representatives (Carlos Abadi and Alan Dayan) of Abadi & Company, an American firm that renegotiates poor

countries' foreign bonds. The meeting was arranged by the former Ecuadorian minister of the Treasury, Armando Rodas, who was also present. During the meeting the businessmen appeared to suggest that the government should announce their refusal to pay \$135 million in interest on private bonds. The resulting panic would allow insurance companies to increase their profit as the value of their contracts with debt holders would multiply. While it was claimed that subsequent stock market transactions would save Ecuador about \$150 million, public outrage over the leaked videos was immense. Correa again exploited this opportunity for immediate political gain with respect to securing the favors of Labor and Industry. An interviewee with intimate knowledge of this process told me that Armando Rodas and Ricardo Patiño met in a talk show after the incident. During a commercial break, Patiño supposedly told Rodas that "I know that you are a good guy, but this is politics" (Rodas, 2011), adding to the notion that Correa's government behaved opportunistically to maximize votes.

I also found the decision regarding which creditor to use was controlled by politicians, not bureaucrats: "Why Ecuador has borrowed from China instead of the IMF just has political reasons" (Anonymous, 2011*b*). While the existing literature on economic development features prominent examples of exceptionally powerful bureaucracies – see South Korea (Wade, 1990; Amsden, 1989; Evans, 1995) – my experience in the field suggested otherwise. Loan officers typically were not isolated from government interests. Instead I found them to directly implement orders of elected officials. For example, when asking Ecuadorian loan officers about the reasons for borrowing from the Chinese, I was told "It is a political decision. I am just following orders." Similarly, the governments of countries such as Ecuador and Angola have created specific positions within their bureaucracy whose appointees are responsible for negotiating loan agreements with the Chinese. Lastly, the lending procedures described in Section 3.3 indicate many opportunities at which politicians can interject their preferences in this process. I therefore argue that politicians, not bureaucrats, determine borrowing decisions.

In sum, politicians in Ecuador perceived the interests of Industry and Labor to be congruent, while Finance was left out. The political decision to focus on loans from China as opposed to the IMF or private creditors was a logical conclusion, if politicians wanted to increase their appeal to Industry and Labor.

6.2.2 Corporatist state-society structure and social movements

While the section above presents evidence that politicians perceived an informal coalition between Labor and Industry, why did decision-makers listen to the demands by the coalition as opposed to the single actor, Finance? I suggest that if the political and institutional characteristics are such that only a small winning coalition is necessary in relation to the selectorate, the likelihood of minimizing the costs of securing that support by catering to the interests of the single actor increases. However, if the country's characteristics require politicians to obtain a comparatively large part of the selectorate to secure a sufficient winning coalition, the likelihood that they will cater to the informal coalition increases.

I argue that the Ecuadorian political economy is characterized by a large number of veto points, and consequently requires politicians to obtain a relatively large winning coalition to attain office or maintain incumbency. In this regard, several interviewees referred to the corporatist structure of the political arena. For instance, one interviewee stated that Ecuador is characterized by a decentralized political arena, in contrast to Peru and Colombia who have fairly centralized political systems (Perez, 2011). It was suggested that the reason for this lies in the presence of a comparatively strong middle class that has its origins in the oil boom of the 1970s (Pachano, 2011, see also Meléndez (2007); Pachano (2009); Paramio and Hopenhayn (2010)) as well as the policies of the military government at the time (Acosta, 2011). This middle class demanded political representation, which resulted in the founding of various new political actors, such as the Democratic Left [Izquierda Democrática] or the Democratic People's Movement [Movimiento Popular Democrático]. However, over time there was no consolidation of the various actors, which

gave rise to the corporatist structure of the political economy. Thus, a wide range of institutionalized associations, such as chambers of commerce and small unions, and a variety of non-institutionalized movements are present. This variety of organizations are thought of as keeping each other in check to a larger degree than in Peru or Colombia, where power is distributed more asymmetrically (Pachano, 2011, see also Mejia-Acosta (2004); Acosta (2009))²

In particular, the civil society in Ecuador was able to insert itself into this structure and hence has a comparatively large voice in the political arena (Espinoza, 2011). This results from the fact that the political parties in Ecuador are dissolving as they are currently viewed as corrupt and not representative. In particular, the financial crisis in 1999 discredited the traditional parties (Paredes, 2011) and revealed them to be instruments of the oligarchy (Acosta, 2011), particularly the banks (Rast, 2011).

Social movements therefore appeared as a viable alternative (Espinoza, 2011). For one, the financial crisis was an opportunity for different social groups to “get their act together” (Salgado, 2011). They were therefore the only political actors openly protesting in the streets. While many people might not have joined them, they were sympathetic to the fact that “someone was doing something” (Paredes, 2011). Consequently, the electorate began to vote for people and movements rather than parties. The first example of this might be the election of Lucio Gutiérrez in 2003, who was the candidate of the January 21 Patriotic Society Party [Partido Sociedad Patriótica 21 de Enero], named for the date of the protest in 2000. He proposed an alliance with the indigenous Pachakutik Plurinational Unity Movement [Movimiento de Unidad Plurinacional Pachakutik – Nuevo País]. He was elected on a platform against Finance, promising the reversal of neo-liberal reforms and fighting corruption. However, it appears that Gutiérrez’ reasons for catering to the interests

² The large number of veto points resulting from the corporatist structure has been used to explain economic outcomes other than the borrowing strategy. For example, Pachano (2007) argues that the implementation of neo-liberal reforms failed because of the multitude of veto points.

of Labor and Industry were opportunistic, as he broke his alliance and continued the neo-liberal reforms of his predecessor, even increasing the amount of bilateral debt obtained from the United States. His government therefore lost legitimacy quickly (Paredes, 2011; Reyes, 2011). The election of Rafael Correa and his Proud and Sovereign Fatherland Alliance [Alianza PAIS Patria Altiva y Soberana] can be seen as a natural progression of these developments. It further contributed to the degeneration of established parties that cater to specific constituencies and supported the growth of broader social movements that took their place. Several interviewees consequently concluded that Correa is the result, rather than the cause, of this development (Pachano, 2011; Detsch, 2011).

In sum, there is much evidence that the current institutional environment requires Ecuadorian politicians to secure the support of a relatively large part of the electorate in order to obtain a winning coalition. Because of the corporatist structure, there is “more space for a multitude of actors to participate in the political process” (Piedra Vivar, 2011). In addition, the degeneration of institutionalized parties and rise of broader movements meant that “[Ecuadorian] governments were more receptive to popular demands” (Espinoza, 2011). In a context characterized by a large number of veto points as well as a vast number of actors, it is no surprise that Correa opted for implementing policies that satisfy the preferences of two actors simultaneously. He chose to cater to the interests of the coalition between Industry and Labor, to the detriment of the single actor Finance, thereby maximizing the appeal of his policies to a wide range of actors.

6.2.3 Favoring Labor and Industry to the detriment of Finance

Both the process of preference aggregation and the required size of the winning coalition give Ecuadorian politicians the incentive to cater to the interests of Industry and Labor. My interviews with government officials confirmed this hypothesis. Specifically, Ecuadorian politicians stated that they favor Chinese loans. The reasoning behind these statements echoed the preferences that representatives of Industry revealed in interviews (see Section

3.7.2. For example, a high-ranking executive of the National Institute of Procurement [Instituto Nacional de Contratación Pública (INCOP)] stated that Chinese loans were chosen because Ecuadorian companies receive subcontracting opportunities that would otherwise not have been available. Similarly, a top-level official of the National Secretariat for Planning and Development [Secretaría Nacional de Planificación y Desarrollo (SENPLADES)] also did not expect negative distributional consequences from Chinese loans, even if they are tied, reiterating statements by Industry representatives (Villalbo Andrade, 2011).

Politicians further echoed the sentiments expressed by Labor representatives during my interviews. For example, one government official in the Public Debt department of the Finance Ministry noted that:

the government needed to have the political force to implement all the constitutional and legal changes that we were elected to do. However, this was not possible with the IMF being around, as it demanded specific changes to laws whenever the Fund was asked to provide a loan. Thus, the political costs were greater than the economic benefits. (Abarca Runruil, 2011)

A different interviewee summarized the government's position with respect to IMF loans as "Our economic model was compromised by these conditions. There are huge social costs" (Anonymous, 2011*c*). Considering this discourse, what type of policies did politicians implement?

My theory predicts that a government catering to a coalition between Labor and Industry will exhibit a high probability of borrowing from BRIC creditors while tending to avoid loans from traditional lenders. Ecuador's aggregate borrowing patterns – summarized in Figure 6.1 – confirm these theoretical expectations. BRIC loans have increased significantly, while Ecuador's exposure to traditional creditors has diminished at the same rate. In addition, interviews with government officials allowed me to gain further details on the loans that Ecuador signed with BRIC creditors (Abarca Runruil, 2011; Minoli, 2011; Villalbo Andrade, 2011; Anonymous, 2011*b*; Soria, 2011).

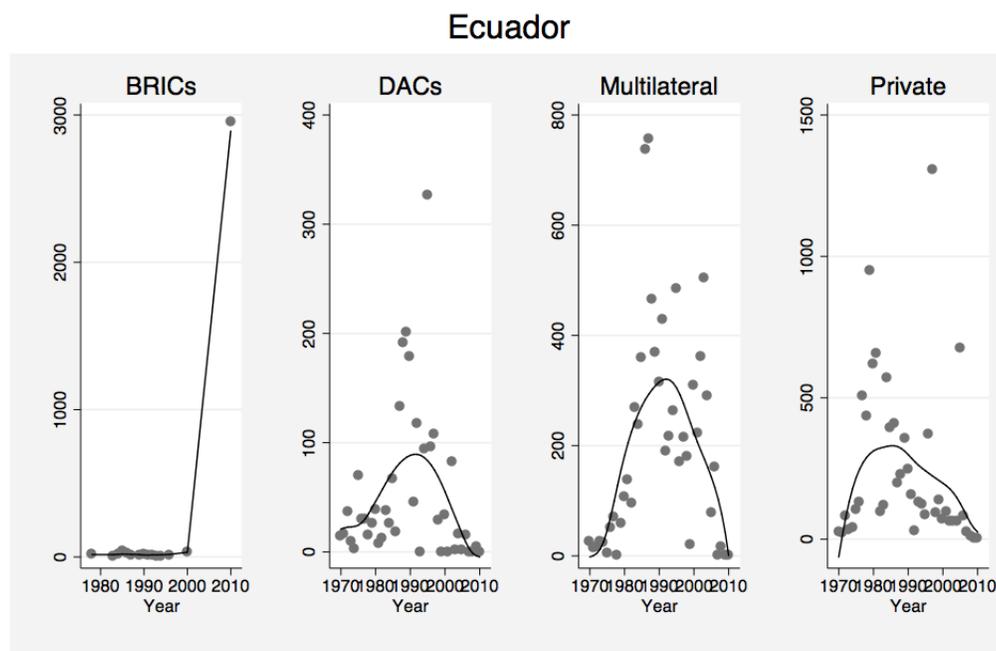


Figure 6.1: Ecuador's borrowing trends with respect to the four types of creditors.

As of December 2011, Ecuador has obtained a total of six loans from China and one from Russia. In 2010, Ecuador obtained a \$1.682 billion loan from the China EXIM bank to finance 85% of the the Coco Codo Sinclair project, a remarkably large hydropower dam that will product 1,500 MW of electricity. This tied loan resulted in the project being awarded to the Chinese company Sinohydro who began construction shortly after the agreement was signed. Ecuador obtained a second tied loan from the China EXIM bank a year later, in 2011. This time, the Chinese loan, amounting to \$0.6 billion, is used to fund the construction of the Sopladora Electrical project that is expected to yield 487.8 MW. The contract was awarded to the Chinese consortium China Gezhouba Group-Fopeca. In addition to Chinese loans tied to specific infrastructure projects, Ecuador has also obtained a tied loan from the Russian EXIM bank. The loan – sources estimate it at \$123 million, but I was unable to confirm this number – is used to finance the expansion

of the Toachi Pilaton hydropower project that will yield 252 MW. It is to be constructed by the Ecuadorian company Constructora de los Andes, COANDES Cía. Ltda, while the Chinese firm Harbin Electric Machinery Co. Ltd. will supply the electrical turbines.

The government has also obtained three loans from the Chinese Development Bank (CDB). In 2010, \$1.0 billion was obtained by the government, of which \$200 million is supposedly tied to a specific project, even though I was unable to find further details on this loan. The remainder is intended to finance various projects in the Plan Nacional de Inversion, but at the discretion of the Ecuadorian government. A year later, Ecuador again borrowed from the Chinese Development Bank. This time it obtained a \$1.4 billion untied loan that is denominated in US dollars. In addition, it also obtained \$0.6 billion, this time denominated in Remnibi and tied to a specific project. Again, it was not possible to obtain further information about the project to be financed.

In addition to these explicit loans, Ecuador has obtained implicit loans. As government representatives do not count these transactions as loans, they are not recorded as such in the budget. However, these transactions involve so-called ‘advance sales of oil,’ through which Ecuador obtained \$1 billion in 2009 and again \$1 billion in 2011. These deals involve the prepayment of future oil exports to China, at a given price today.

The terms of Chinese loans are rather expensive in comparison to funds available from multilateral organizations, but are comparable to the terms offered by the EXIM banks of western governments such as the US EXIM bank or the German Hermes Bank. The average terms of the Chinese loan commitments of 2010 are characterized by a grace period of 4.5 years with a maturity of just over 11 years while the average interest rate is 6.56%. This results in an average grant element of 14.66%.

As a result of these borrowing decisions, Finance is angry while Labor and Industry are content. One interviewee, for example, told me that “The rich are not happy [...]. They [would] rather have relations with the US or Europe” (Villalbo Andrade, 2011). Similarly, a Peruvian businessman had just returned from a visit to Ecuador where he had spoken with

his partners, most of whom are in the financial sector, and all of whom were ‘depressed’ because “Correra is somewhat of a nut” (Kuczynski, 2011). Private Ecuadorian bankers lamented that the government is listening to the interests of social movements rather than Finance. After all, “the Jubileo 2000 group are crazy people. The CAIC was a circus rather than an investigation” (Anonymous, 2011*c*). Yet, the approval rating of Correra is consistently between 60% – 70%. One observer noted that “this is because people think that there is finally someone who takes their problems seriously” (Detsch, 2011).

In addition to borrowing decisions reflecting the joint interests of Labor and Industry, the Ecuadorian government also implemented policies in other areas that cater to the interests of this coalition. For example, all investment protection treaties that Ecuador had signed before 2008 were renounced that year and the order given that such treaties are not to be signed again in the future. The reason was that these treaties “overprotected foreign investment” by granting foreign firms more rights than domestic companies. For example, the arbitration clauses of these treaties allowed foreign companies to sue Ecuadorian public and private actors in foreign courts, while domestic firms did not have this possibility (Piedra Vivar, 2011).

Similarly, Ecuador has not signed the Agreement on Government Procurement (GPA) within the World Trade Organization (WTO). This agreement would give foreign companies the same rights domestic firms enjoy with respect to procurement processes. However, a government official confirmed that Ecuador would like to preserve the option to implement industrial policies in order to nurture domestic companies. After all, “When big international firms come Ecuador does not stand a chance” (Gonzalez, 2011). A government official further told me that they follow academic research on the topic of industrial policy, such as Ha-Joon Chang’s book *Kicking Away the Ladder* (Chang, 2002). Similarly, his department produced a Spanish translation of a paper entitled “Public Procurement as an industrial policy tool – An option for developing countries?” (Kattel and Lember, 2010).

In sum, the policy decisions by the Ecuadorian government can be explained with a straightforward political calculus. Correa faced an environment where the interests of Labor and Industry are congruent. In addition, because of the corporatist structure of the political arena, he required a relatively large number of supporters to create a winning coalition. His decision to implement policies that satisfy the demands by two actors simultaneously maximizes his political gain. The decision to borrow from BRIC countries instead of traditional lenders therefore represents a coherent political strategy.

6.3 Colombia - a Capital coalition

6.3.1 The Dutch Disease and export worries

On August 16th, 2011, the front-page story of Colombia's largest daily newspaper 'El Tiempo' was concerned with President Santos' proposal to contain the negative effects of the 'enfermedad Holandesa,' the so-called Dutch Disease. This 'disease' can befall countries that discover new reservoirs of natural resources, just as Colombia had at the time. Its symptoms include rising inflation as well as a loss in competitiveness of the export sector. According to my theory, this would imply that the conditions of the Colombian economy would indicate that the interests of Finance and Industry would be congruent. In fact, when talking with Colombian politicians, the keywords 'export competitiveness', 'inflation', and 'domestic finance' were among the most frequently used terms. For example, an interview with a Colombian senator quickly zoned in on this issue, discussing the different approaches that have been suggested with respect to containing the negative macroeconomic effects. For his part, he proposes to capture these windfalls in order to strengthen the domestic industrial sector by setting up a fund that would finance public investments (Laserna, 2011). Other observers note that much of Colombia's industrial sector is export oriented (Espinoza, 2011). Because of this characteristic, several interviewees mentioned that they are concerned about the effects of the Dutch Disease on domestic industry. In

the words of a former Deputy Minister for Business Development, “The Dutch Disease could hurt domestic industry” (Duarte, 2011). While “we will become very rich in terms of exporting raw materials” (Junguito, 2011), the macroeconomic effects of the Dutch Disease include the contraction of the domestic tradable sector such as manufacturing. Analysts consequently expect that Industry is more concerned with the political discourse on the Dutch Disease than the possibility of obtaining Chinese loans (Reina, 2011). A former deputy minister of the National Planning Department [Departamento Nacional de Planeación (DNP)], predicted that the effected businesses are busy lobbying government to do something about it (Escobar Arango, 2011). A representative of Colombia’s National Business Association [Asociación Nacional de Empresarios de Colombia (ANDI)] confirms that its members have urged ANDI to take action. After all, “When ANDI calls, people listen” (Salamanca, 2011)

The desire to assist Industry and Finance is also visible in the way politicians talk about the National Development Plan [Plan Nacional de Desarrollo]. This plan includes all investment projects the government intends to initiate over the course of its term. A former representative of the National Planning Department suggests that it is the primary instrument with which politicians organize their electoral support (Escobar Arango, 2011). Others point to this process as a source of campaign financing from businesses in their constituencies (Rettberg, 2011). As the timing of the political business cycle is conducive, electoral support can be secured by promising investment projects that are to be constructed by Industry and financed by Finance. For example, President Santos was elected on August 7, 2010, and the constitution mandated that the National Development Plan had to be approved by May 2011. However, the regional elections were scheduled for October 2011. As this sequence of events is the same for every incoming administration, there is always an incentive for politicians to secure their electoral support in regional elections via the projects that are negotiated just prior to these elections. An interviewee provided me with the example of coal mines in the mountains just north of Colombia’s capital city,

Bogota. In order to exploit these resources, a new road and better transport options on the nearby river were needed. Naturally, Industry showed much interest in this project and therefore lobbied in Congress to have it included in the list of projects of the Development Plan (Escobar Arango, 2011). In addition, analysts point out that businesses have a strong voice in the process of creating the National Development Plan. As Congress only votes on the entirety of the plan, most of the political action occurs in the subcommittees where the constitution requires that all relevant stakeholders must be included in the consultations. However, observers note that both Industry and Finance are overrepresented in these committees, while organizations associated with Labor (i.e. indigenous or societal groups) are underrepresented (Rettberg, 2011).

The Plan has been described as a “monster” that results from an evolutionary process where in the end “something appears” (Laserna, 2011). Initially, there are hundreds of projects suggested, and the Planning Department then proceeds to filter projects. However, once the first draft comes back to Congress, a Congressman tells me that “we pump in as many demands as we can and then hope for a good batting average. [...] After all, I am a conservative, and I am running a populist campaign against the two foreign investors in my region” (Laserna, 2011). Because of this process, “anything can happen. [...] Congress is a black box – a very threatening black box” (Reina, 2011). However, when it comes to the actual implementation, observers note that primarily the pet-projects of the politicians get implemented, while the projects suggested by the technocrats in the Planning Ministry are likely to fall off the table (Reina, 2011).

In sum, it appears that the characteristics of the Colombian economy provided politicians with the incentive to think of Industry and Finance as an informal coalition. Faced with the dangers of the Dutch Disease, their interests are aligned. In addition, the interests of this coalition are overrepresented in comparison to those of the single actor, Labor. It is therefore no surprise that the politicians I talked with conceptualized Finance and Industry as an informal coalition opposed to the single actor Labor.

6.3.2 Politics managed by elites for elites

How do politicians choose between implementing policies in the interest of the coalition or those of the single actor? I argue that the political economy of Colombia gives politicians an incentive to cater to the coalition between Industry and Finance, rather than the single actor Labor.

Colombian politics appears to be managed by elites. Interviewees describe the political system to be dominated by the “oligarchy” that resulted in a relatively exclusive political system, as a ‘pact’ between the Liberals and Conservatives essentially consolidated their power (Pachano, 2011; Espinoza, 2011). Nevertheless, there is some change: ever since the new constitution was implemented in 1991, small and regional parties have been springing up. However, these were either incorporated by existing parties (Pachano, 2011, also, see Leongómez (2002)), or vanished again as they were based on the aspirations of office-seeking politicians that did not stand a chance against the established parties (Nupia, 2011). Thus, unlike in Ecuador, the Colombian party system is not unraveling³ .

Part of the reason for this phenomenon is that parties have strong ties to some parts of society – namely Industry and Finance – while Labor is not strongly represented (Espinoza, 2011). Several interviewees mentioned that business groups are the primary social forces in Colombia (Junguito, 2011; Reyes, 2011). In particular, business associations representing export industries have developed a strong capacity to lobby on behalf of their constituency (Rettberg, 2011). Also, one academic told me that “Colombians are not sitting there and waiting for foreigners to come to Colombia. [...] There exists already a stock of domestic entrepreneurs who are capable of investing and defending their interests” (Thiell, 2011).

In addition to strong business groups, broad popular movements that might represent Labor have not been able to develop. In the context of the Colombian internal war, there was no political space for social groups. One interviewee told me that “if you were a bit

³ Despite the fact that both of the most recent presidents, Uribe and Santos, won their presidencies officially on independent tickets, informally they have strong ties to existing parties.

left, then you were immediately thought of being part of the FARC⁴ ” (Salgado, 2011). In contrast to Ecuador, the war in Colombia precluded any opportunity for social movements to get a foothold in the political system, further contributing to the consolidation of parties representing Finance and Industry (Acosta, 2011; Reyes, 2011; Piedra Vivar, 2011).

Even though Colombian politics appears to be managed by elites, the likelihood of politicians catering to the single actor is not higher than in Ecuador. The reason is simple: While the required size of the winning coalition is smaller, so is the selectorate. Thus, the exclusion of Labor from the political area weighs less heavily as the elite themselves are diverse. Several interviewees stated that Colombian elites are dispersed geographically, as there are several industrial hubs (see Cali, Bogota, Medellin, etc) unlike in Peru where all political and economic life is concentrated in Lima (Pachano, 2011; Alvarez, 2011; Paramio and Hopenhayn, 2010). In addition, elites differ in terms of their roles in the economy as there are both strong banking interests as well as business interests. In other words, both Industry and Finance control veto points.

In sum, because a smaller minimum winning coalition coincides with a smaller selectorate in addition to a high level of heterogeneity within the elites, Colombian politicians have the incentive to cater to the interests of both Finance and Industry.

6.3.3 Politicians partial towards Finance and Industry and neglecting Labor

As a result of these domestic considerations, politicians need to consider the interests of Industry and Finance in international negotiations. For example, Peruvian officials have noted that the Colombian private sector has quite some influence over economic foreign policy (Anonymous, 2011*g*). For instance, a Peruvian official involved in negotiations in the context of the Free Trade Area with the United States recalled that Peru wanted to

⁴ FARC stands for Fuerzas Armadas Revolucionarias de Colombia, the Revolutionary Armed Forces of Colombia. A MarxistLeninist revolutionary guerrilla organization, among the most prominent armed groups involved in the war.

negotiate en bloc with the Colombians. However, this proved to be difficult, because Peru was much more willing to liberalize economically than Colombia. The interviewee stated that “the Colombians were quite complicated. They can be difficult. Why? Because Colombia has a strong private sector that pressures the government to be more cautious” (Illescas, 2011).

Similar caution is visible with respect to sovereign loans. Recall that Section 2.3 characterizes BRIC loans as so-called tied loans. For example, the Chinese typically require debtors to use the loan to obtain services or materials from Chinese companies. While these arrangements do not deter Ecuadorian officials from BRIC loans as there are no Ecuadorian companies capable of constructing the projects, the situation is different in Colombia where the industrial sector is more developed. Thus, tied loans would mean crowding out Colombian companies in favor of Chinese ones. Another Colombian observer noted, “If the Chinese come to Colombia, then they must have outmuscled somebody else” (Steiner, 2011), while a Colombian observer added that “Peru has been much more neoliberal than Colombia. They opened up totally and believed in the internationalization of the economy. Colombia is one step behind. We believe in Free Trade, but not that much” (Reina, 2011).

Consequently, Colombian politicians are generally against tied loans. For example, a former official of the Colombian Ministry of Foreign Relations told me that “while the government wants to establish more ties to China, it is also somewhat hesitant. We see a big monster – and we don’t know what they want” (Garcia, 2011). Official borrowing guidelines therefore disadvantage BRIC loan proposals. While there is no explicit law that prohibits these type of loans, Colombian law does mandate that all projects financed with external resources must go through a sequence of bidding processes. The government will first attempt to secure funding through a bidding process, soliciting loan offers. Once the funding is obtained, a separate bidding process awards the contract for the project construction. Naturally, this puts Chinese loan offers at a disadvantage, as proposals that require the funds be used for a particular construction company are not permitted.

In addition to the difficulties of participating in the first bidding process on the financial aspect of projects, several interviewees stated that the Chinese are also disadvantaged with respect to the second bidding process concerning the project construction. They are caught in a dilemma: In order to win a contract, a foreign company needs a Colombian partner (Salamanca, 2011; Chacón Peña, 2011*b*; Guarín, 2011). However, as evidenced by Section 3.7.1, it is difficult for Chinese companies to win that Colombian partner. This makes it difficult to establish a track record in the Colombian economy, which incidentally is another requirement for eligibility to bid on public tenders (Perry, 2011). In the words of a former Colombian ambassador to China, “companies are required to show that they have some experience in making business in Colombia as an indication that you are able to do business successfully. However, this is a Catch 22: You only get experience by having won a tender, which you can’t win without experience. It is like a glass wall - the Chinese can see the light at the other side, but they can’t get there. They just bang their heads at the glass wall. It is a Dead-Flies-Syndrome” (Gaviria ’Angel, 2011).

By assuming a seemingly neutral role as an arbiter with an exclusive focus on organizing a bidding process, the government can effectively exclude Chinese loans and companies in favor of domestic Finance and Industry. One official in the Colombian Foreign Ministry therefore stated that:

[The Chinese] always have the government-to-government process in mind, but it works differently there. As essentially all [Chinese] enterprises are state owned, for them, if a government official says that I want you to undertake this project, then it is understood that it is a specific project given to a certain country or a certain company. However, we always have to go through a bidding process. Thus, they have to enter and compete [with other companies in the bidding process]. This process is open to any investor, whether domestic or foreign. But we cannot direct a bidding process to a specific country - we cannot discriminate among investors. [...] It has been quite difficult with [the

Chinese], as it is another way of doing business. It is understandable that they say 'I am giving you a very cheap financing option, thus I have to be the one to implement it,' but we cannot do it as it would imply to direct the bidding process (Benetti, 2011).

In sum, this leads to the situation where public officials can credibly claim that "If the Chinese want to come and if they meet the legal requirements set out then they are more than welcomed" (Ríncon, 2011). Yet, it is extremely difficult for the Chinese to participate in this process. Thus, while it is true that – in the words of a Colombian senator – "Colombia has the better institutions than the other countries where there is more Chinese investment" (Laserna, 2011), the implicit notion that the Chinese only go where there are bad institutional environments is not necessarily correct. Rather, at least for the Colombian case, the Chinese would like to go to a place with good institutions, but they cannot do so. There is no legal discrimination based on nationality, which would be illegal as Colombia is a member of the WTO (Peña, 2011). Yet, *de facto* discrimination against the Chinese exists, and it serves the interests of Finance and Industry. The former benefits from these rules as it is in a strong position to offer financing to the government, securing a captured clientele. After all, "you have to use a bidding process by which to give concessions to *private* actors" (Benetti, 2011). The latter benefits, as it does not face strong competition from Chinese enterprises that also could construct the respective projects.

It is not the case, however, that Colombian politicians are not tempted by Chinese loans. Particularly large infrastructure projects require massive investments. As one official noted, "the development banks in Asia are usually prepared to fund these large projects" (Rojas Hayes, 2011). The official added that the Colombians would be fine with the Chinese financing and building the project, but only if the Chinese would be willing to win both bidding processes separately. Another official admits that "[our process] makes it more difficult to undertake certain kinds or projects. For example, sometimes some countries

have a better technology than others, so you [as a government] prefer them, but you cannot direct the bidding process to them” (Benetti, 2011). Thus, in the end, public officials side with domestic Industry and Finance: “Of course [the Chinese loans] are very interesting as they are cheap and have long periods of amortization and grace periods - thus they would be good for the debt portfolio. [...] Obviously, free money is interesting, but free money also comes with an agenda – it’s all tied, and it is difficult and cumbersome” (Rojas Hayes, 2011)

Following these considerations, it comes as no surprise that Colombia has not obtained loans from China. However, it is challenging to prove that there were Chinese loan offers if actual loan agreements never materialized. My fieldwork nevertheless confirmed that Colombia had several opportunities to borrow from the Chinese. After all, a public official in the department that coordinates Colombia’s external relations with Asian countries stated that “loans with China have *not yet* worked out” (Anonymous, 2011*e*), implying that there were talks. For one, the Chinese are available for negotiations. In fact, the Chinese Development Bank has maintained a permanent office in Bogota since 2007 (Guarin, 2011). In addition, loan offers have been extended to the Colombian government. Public officials told me of loan proposals by the China Export-Import bank that were rejected by the government (Chacón Peña, 2011*a*). The economic and commercial counselor to the Chinese ambassador also confirmed loan offers, but noted that the Colombian government has been hesitant to accept these offers (Quan, 2011).

In addition to these general loan offers, it is known that the Chinese offered to finance several public works projects. For example, in 2005 Colombia wanted to build an alternative to the Panama Canal, a so-called Canal Seco [Dry Canal]. The government inquired whether foreign creditors – the Chinese among them – would be interested in financing this project. While an official involved in this process told me that the Chinese were initially thought of highly, they were not selected for the project (Garcia, 2011; Leiteritz, 2011).

In addition, government officials confirmed that the Chinese offered a loan to the State-Owned Enterprise ColPetrol. Yet again, this loan offer was rejected (Rojas Hayes, 2011). Lastly, Colombia rejected a Chinese loan offer for financing a hydropower project, the Acueducto Metropolitano de Bucaramanga. Instead it favored borrowing from a regional multilateral organization, the Andean Development Corporation [Corporación Andina de Fomento (CAF)]. However, as these negotiations fell through, Colombia still did not use Chinese money but rather borrowed from a private creditor, Bancolombia.

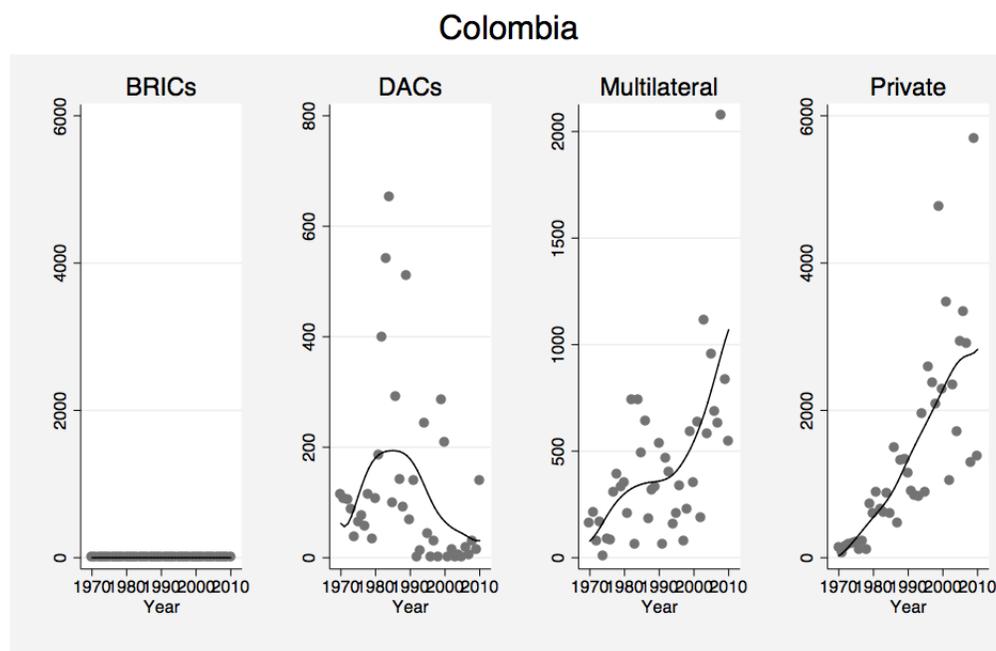


Figure 6.2: Colombia's borrowing trends with respect to the four types of creditors.

In sum, the Colombian government had many opportunities to obtain loans from China. Instead, it chose to explicitly reject those loan offers and borrow from traditional lenders such as the IMF, western governments and the private capital market. As evidenced by the aggregate data displayed in Figure 6.2, Colombia continuously expanded its exposure to multilateral and private creditors. Yet, it did reduce its dependence on bilateral loans

from DAC countries. As the decisions of the Colombian government are consistent with the theoretical expectations with respect to a Capital coalition, this case therefore provides strong evidence for my theoretical framework.

6.4 Peru - a Consumer coalition

6.4.1 Projects as signals

Several interviewees emphasized that one crucial difference between Colombia and Peru is the role that Industry plays in the political arena. Colombia has a strong manufacturing basis and a solid stock of entrepreneurs, while Peru's exports are primarily stemming from foreign-owned mining operations. A former government official therefore noted that the Colombian government has to pay much more attention to domestic Industry's concerns than Peru. According to him, the reason for these differences in the political influence of Industry lie in recent economic history. Peru's economic crisis in the 1990s was solved with radical doses of neoliberal medication, which hurt businesses with fixed capital more than mobile capital (Illescas, 2011). Similarly, other interviewees see the crisis as the reason for Labor's role in the political discourse. As the depth of the financial crisis in Peru was much stronger than in Ecuador – primarily due to failed leftist economic policies of President Alan Garcia in the 1980s – Labor “hailed anything new as the new solution” (Espinoza, 2011). Thus, Fujimori was able to succeed in establishing the liberal project. It appears that the success of those policies curbing inflation have had a long-lasting effect on Labor's political preferences, similar to how Germany's anti-inflationary preferences are commonly explained with the memory of hyperinflation in the 1930s. In sum, Labor's interests appear to be aligned with those of Finance rather than Industry.

At the same time, there are indications that Finance's interests are generally more aligned with Labor than Industry. For example, a high-ranking manager of a private Peruvian bank revealed that his bank has significant difficulties competing with the multitude

of foreign banks that have come to Peru since its financial liberalization. This necessitated a change in strategy: instead of competing with foreign banks for funding large, capital-intensive projects, his bank is now focusing on serving consumers or even small entrepreneurs in the informal sector. He stated that this is a logical decision as “the margins are bigger and we can avoid the competition of foreign banks, particularly because we have more local knowledge” (Quevedo Ocampo, 2011). A representative of a different bank told me that they also changed their strategy for similar reasons. Thus, they are not providing financing for large projects anymore, but rather focus on administering accounts and offering financial services for smaller clients (Alzamora, 2011).

Considering that Finance and Labor appear to have congruent preferences, politicians appear to think in terms of an informal Consumer coalition. Thus, they have the incentive to cater to these societal groups. For example, a former prime minister of Peru noted that there was general support for establishing a Free Trade Agreement with China. While the local textile industry lamented the expected negative effect on domestic clothing production, the population was in favor of lower prices – which propelled the government to sign the FTA agreement (Kuczynski, 2011).

A more elaborate illustration of politicians catering to Finance and Labor is the way the governmental department, Proinversion, works. Just as Colombia’s National Planning Department coordinates domestic investments, it also organizes the process of selecting projects that are to be financed and implemented over the course of the incumbent’s term. This process is a major political battleground, as politicians seek to secure electoral support by obtaining projects for their constituencies (von Hesse, 2011). However, unlike in Colombia where politicians act primarily in the interests of Industry and Finance, Peruvian politicians’ behaviors cater to the interests of Labor and Finance while disregarding Industry. For example, one former government official told me that in 2008 and 2009 the president issued two decrees to boost the economy during the economic downturn. The highly-publicized decrees ordered that 12 and 20 investment projects, respectively, were to

be implemented within a year. However, only five of these 32 projects were realized. One observer noted that “this was a populist action to show the people that the government is doing something. However, these kinds of projects need more time for preparation” (Illescas, 2011).

More generally, the process of selecting public investment projects appears to be motivated by populist reasons, rather than business considerations. One indication for this is the different quality of project preparation when comparing Colombia and Peru. As Colombia caters to the interests of Industry, the Colombian government has an interest in proposing realistic projects that can be expected to be implemented, and therefore actually benefit Industry. In contrast, Peru’s Proinversion appears to announce projects despite a lack of preparation. A former Deputy Minister of the Economy admitted that in Peru there is no priority list of projects that the public hand wants to undertake: “There is no plan, and consequently no technical studies regarding the feasibility and viability of potential projects” (Morón Pastor, 2011). Officials of the Central Bank further indicated that there are two types of project proposals. Some proposals are well prepared and come with feasibility studies, while others lack sufficient documentation (Armas, 2011; Vásquez Sanabria, 2011). This was confirmed by an official working within Proinversion (Herrera, 2011).

Several interviewees made consistent statements regarding the reasons for this state of affairs. The problem is that the board of Proinversion consists of five Ministers – not technocrats familiar with project finance and implementation (Illescas, 2011). It is therefore not surprising that technical experts do not have a voice at board meetings. Under the condition of anonymity, one former participant of these board meetings told me that a Minister barked at him: “If you are not a minister, you are just taking notes.” He added that “that’s why my wife is quite happy that I changed jobs. It is hard to raise my voice when something can happen to you.” Another interviewee added that “the meeting is completely informal. There are no rules. There is not even the obligation to present written reports before presenting a project to the board” (Illescas, 2011).

Under these conditions, politicians “[...] have the political incentive to propose projects regardless of their cost-benefit analysis” (von Hesse, 2011). Consequently, “technical decisions were not respected if [the board members] wanted something” (Morón Pastor, 2011). A former public official pointed out that the well-prepared projects, which included a formal presentation along with the necessary legal and technical reports disseminated prior to the meeting, were generally the projects prepared by Proinversion staff members. However, if projects were proposed by Ministers, they were generally presented in an *ad hoc* fashion, without prior documents, without technical expertise disseminated beforehand, and even without PowerPoint slides – just a oral presentation at the meeting (Illescas, 2011). In addition, the political business cycle appears to further reinforce the tendency to produce poorly-prepared proposals. Interviewees noted that the political cycle of incumbents being elected for either 4- or 5-year terms does not coincide with the cycle of a typical project that lasts about seven years from planning to implementation. Thus, for a politician to use a project as a signal to his constituency, he needs to speed up the process. This can most easily be accomplished by disregarding the need for careful legal and technical studies (von Hesse, 2011).

To summarize, the high number of project proposals, their poor preparation, and the subsequently low number of projects realized suggest that this process serves populist considerations rather than business interests. Project announcements serve as signals by incumbents to Labor, while the interests of Industry in viable project preparation are disregarded. Considering the lack of domestic manufacturing, as well as the high number of firms operating in the informal sector, this focus on the interests of Labor is logical.⁵

In conclusion, the structural characteristics of the Peruvian political economy gives

⁵ However, to be fair, it is difficult to determine whether projects are done for Labor or for Industry. While my account above is consistent with most views articulated by interviewees, there were voices implying that Industry is the beneficiary of this process. After all, there are instances where “it is not what the government deems important that is implemented, but pressures from the private sector generate the project” (Morón Pastor, 2011). Similarly, there are instances where private investors approach Proinversion to propose a project. Thus, the lack of information on the part of the project proposals could also be explained by the lack of ownership. Nevertheless, on balance, my experiences with interviewees in Peru –

politicians the incentive to think of an informal coalition between Labor and Finance.

6.4.2 Finance for the people

If politicians have the incentive to think in terms of an informal coalition between Finance and Labor, with Industry being the single actor, will politicians cater to the coalition or the single actor? I argue that the characteristics of the political economy give Peruvian politicians reasons to act in the interests of the coalition.

While interviewees noted that Peru does not have a large middle class, it does have a large popular sector (Pachano, 2011). However, its representation is somewhat vague: left parties were discredited by unsuccessful economic policies in the 1980s, and subsequently “destroyed” by Fujimori (Acosta, 2011). At the same time, the popular sector did not organize in social movements either, partially because of their repression by Fujimori (Salgado, 2011) and cultural factors (Reyes, 2011). The crisis of representation due to Fujimori’s dictatorship also resulted in weak parties generally, none of which are particularly appealing to the popular sector (Espinoza, 2011). This led one interviewee to note that “there are only independent politicians who run on the platform of their own newly-founded party. To win elections, these newly founded platforms need to find a way to get votes” (von Hesse, 2011). This suggests that the size of the selectorate is considerable, and thus requires a comparatively large winning coalition.

Yet, several interviewees also pointed out that in contrast to Ecuador, Peru has a consolidated political arena, partially because of Lima’s geographic concentration and isolation (Espinoza, 2011; Paredes, 2011). However, it appears that the oligarchic elite are of financial rather than industrial character. Interviewees noted that it was probably easier for owners of mobile capital to survive the neoliberal reforms of the 1990s in comparison to owners of fixed capital, which might be the reason why Colombian Industry is judged to have more influence over foreign economic policy of their government than their Peruvian

particularly in comparison to Colombia – gave me reasons to conceptualize the processes in favor of Labor as opposed to Industry.

counterpart (Anonymous, 2011*g*).

In sum, Peru, of late, appears to be characterized by a strong political position of Finance with some support required from the large popular sector. It therefore appears as if the ratio of winning coalition required and the size of the selectorate are similar to that of Colombia and Ecuador. This is confirmed by the estimates of W/S by (Bueno de Mesquita et al., 2005). Consequently, Peruvian politicians would also have the incentive to cater to the interests of the coalition instead of the single actor – the difference being that the coalition here is between Finance and Labor, as opposed to Finance and Industry (Colombia) or Industry and Labor (Ecuador).

6.4.3 Support for Labor and Finance while Industry is passed over

Following these considerations, we should expect Peruvian politicians to implement policies catering to the interests of Finance and Labor. The contrast between the treatment of domestic Industry in Colombia and Peru is instructive in this regard. For example, unlike Colombia, Peru does not have a governmental program designed to help domestic industry to become competitive on international markets. Instead, Peruvian industry has been complaining about the lack of government support. One interviewee told me about projects proposed by Industry that were stalled by local communities. As Industry was out on a limb in such a situation, a ‘No’ by the local community usually meant the end of the project. Industry therefore demanded that the national government play a role in these negotiations in order to ensure that the community revises its opinion if the proposal is indeed reasonable (Morón Pastor, 2011). In addition, unlike in Colombia, there are no registration requirements by the Peruvian government for foreign investors. A representative of a Chinese institution that asked to remain anonymous noted that “after the decision is made to invest, there is no requirement to register this investment. There is absolutely no obligation to tell the Peruvian government that you are in the country” (Anonymous, 2011*d*). Lastly, as eluded to in Section 6.3, Colombian lawmakers ensure that tied loans

are impossible by requiring that the financing of the project is obtained first before the bidding on the actual contract begins. In Peru, the opposite is the case as a company first wins the bid for a particular project, and is only then responsible for securing the necessary funds from either public or private sources (von Hesse, 2011). In the words of an official of Proinversion, “There is no requirement to first obtain financing and then organize the procurement separately. I am just looking for you to invest. It is up to you how you finance the project. It’s your business. We are only interested in royalties” (Herrera, 2011)⁶ .

Considering this procedure, it is not surprising that the Peruvian government did not solicit Chinese loans for particular projects. There are no tied loans because projects can be financed by the companies directly. The companies, in turn, use the Chinese policy lending institutions such as the China EXIM bank or the Chinese Development Bank (CDB) (Tangri, 2011). If there is a Chinese element to the project, the banks state that “we are glad to support them” (Su, 2011). In particular, with respect to the Peruvian case, representatives of the CDB told me that their headquarters in China can transfer the resources directly to the Chinese company HQ that is also located in China. While the money therefore never leaves China, “Peru doesn’t care where the money comes from as long as there is investment in Peru” (Su, 2011; Ming, 2011). Peruvian observers only see that the Chinese use their own resources and do not even have to issue equity to finance their operations (Alzamora, 2011; Kuczynski, 2011; Cooper, 2011)

Examples of this practice are the Toromocho Mining project, where the Chinese company ChinalCo obtained \$2.5 billion from the Chinese EXIM bank (Barrenechea Ch, 2011). Similar financing arrangements also amounting to \$2.5 billion were made for the Galeno copper mine by China MinMetals. Lastly, the \$1 billion expansion of the Marcona mine owned by Shougang was financed with “\$800 million of Chinese resources and only \$200 million by various Peruvian banks. However, they don’t really need our money,” as a

⁶ However, one interviewee stated that the sequence is actually the other way around: Once the financing is obtained, the responsible Ministry starts a bidding process for the execution of the project (Felix, 2011). While a credible interviewee, he was the only one suggesting this order of events.

Peruvian banker told me (Alzamora, 2011).

Considering that this financing practice is possible in Peru, the government has consequently not borrowed from BRIC countries since their rise to become major creditors, as confirmed by both Central Bankers and government officials (Armas, 2011; Anonymous, 2011*g*; Carbajal Vela, 2011). While Figure 6.3 shows an increasing trend in BRIC borrowing, it remains at a minimal level in comparison to borrowing from other sources. In line with the theoretical expectations from a Consumer coalition between Finance and Labor, the government has reduced its exposure to multilateral loans in recent years. While there are still some multilateral loans, one Peruvian observer commented that the last World Bank loan was obtained “less for the money, but more to get the technical cooperation” (Morón Pastor, 2011). However, contrary to the theoretical expectations, Peru covered the majority of its financing needs not by borrowing from DAC creditors. Instead, it chose to borrow from another traditional creditor, the private market. In sum, two of the four borrowing patterns exhibit trends that are consistent with my theory, while the two remaining trends do not. However, I do not view these last two ‘incorrect’ trends as strong evidence against my theory. After all, one traditional creditor (DACs) was substituted for with another traditional creditor (private creditors), *but not with an emerging creditor*. I therefore conclude that the qualitative evidence collected in Peru provides support for my theory regarding its fundamental theoretical mechanisms suggested, while the observed borrowing patterns provides only partial support for my theory.

In sum, the findings from the fieldwork in Ecuador, Peru and Colombia provide support for the argument that informal social coalitions have a strong impact on the borrowing decisions of their governments. The qualitative evidence presented in Section 3.7 demonstrates that the preferences of Labor, Industry and Finance vary across the creditors available. This chapter complements the analysis by establishing that governments are sensitive to the distributional consequences that follow from their choice of loans. It is therefore no surprise that the governments of Ecuador, Peru and Colombia respond to the preferences of

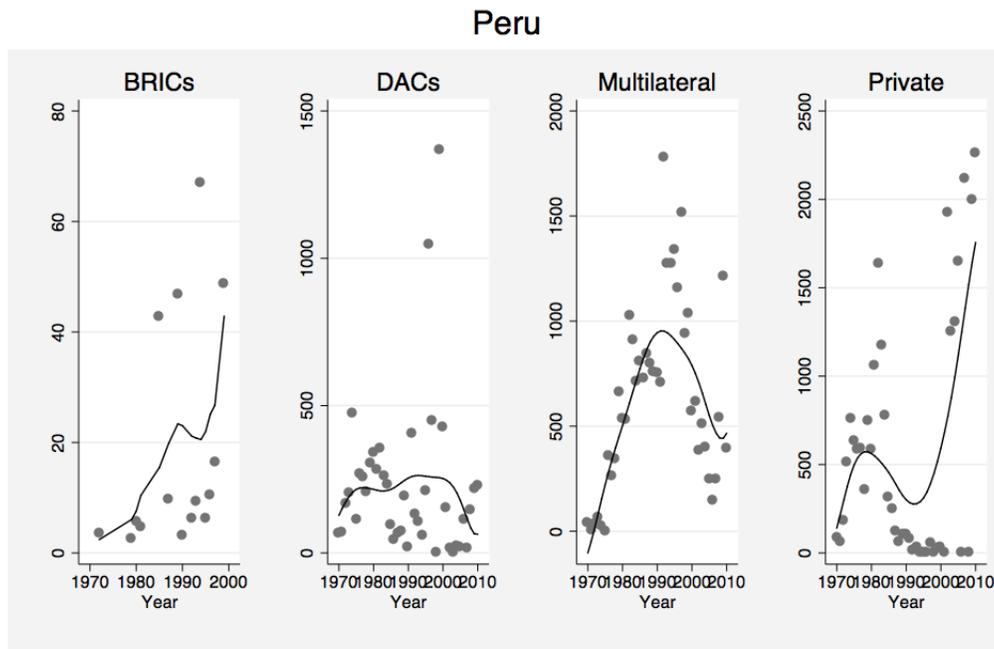


Figure 6.3: Peru's borrowing trends with respect to the four types of creditors.

the social coalition that dominates their respective political arena by favoring the preferred creditors of the respective social coalition.

Chapter 7

Conclusion

7.1 Theoretical advances

Loans from BRICs to developing countries have increased substantially over the course of the last decade. The emergence of these new sovereign creditors has had tremendous impact on both sovereign borrowers and traditional creditors. For the first time in recent history, developing countries have an outside option, and, therefore, the opportunity to decide against borrowing from the traditional creditors. The emergence of BRICs is responsible for the erosion of the quasi-monopolistic position traditional creditors benefitted from in the past.

The central aim of this study is to explain the choices that governments make when presented the opportunity to borrow either from traditional creditors or emerging lenders. Conventional wisdom was quick to provide answers to this question, pointing to issues such as natural resources or the recipient government's ideology. I show that these explanations fall short of providing a comprehensive explanation for BRIC loans. Instead, I argue that the decision between BRICs, DACs, IFIs and private creditors is explained by domestic social coalitions whose preferences vary across creditors based on the distributional consequences they expect from the respective loans. The nature of my argument introduces

several theoretical advances to the study of sovereign debt.

First, the current literature on sovereign debt primarily focuses on whether or not governments borrow from a single type of lender. Scholars have therefore analyzed when developing countries borrow from the IMF (Copelovitch, 2010*b*; Vreeland, 2007) or the private market (Tomz, 2007). However, I argue that countries – just as individuals – are faced with a maximum amount of debt they can obtain. Given such a constraint, the decision to borrow from one creditor is also a decision to not borrow from another. I therefore develop an argument that takes account of these interdependencies. My theory provides a unifying framework that explains how developing countries choose *between* several borrowing options. This advancement on the conceptual level is matched by a novel empirical strategy that focuses on estimating debt *portfolios* instead of loan amounts obtained from a single creditor in isolation.

Second, existing scholarship has attempted to explain lending decisions primarily from the creditor's perspective. This applies both to the literature on traditional creditors, such as the IMF (Copelovitch, 2010*a*; Stone, 2004), as well as the emerging scholarship on Chinese lending (Brautigam, 2009). However, I argue that recipient governments cannot simply be conceived of as passive factors. Instead, developing countries need to be conceptualized as actors with their own incentives, preferences, and motivations. The theory outlined in this study accounts for this by proposing a demand-side theory that understands recipients as dynamic actors.

Lastly, with few exceptions, scholars working on issues of sovereign debt have conceptualized recipients as unitary actors (Marchesi, 2003; Putnam, 1988). While disaggregating the unit of analysis is commonplace in the related literature on the political economy of trade, the scholarship on debt assumes that recipient governments are a homogenous unit. This prevents existing scholarship from analyzing the implications of coalitional dynamics between various domestic interest groups for sovereign debt. My theory addresses this shortcoming by explicitly modeling the diverging references of various societal groups as

well as the mechanism by which these preferences are aggregated and consequently implemented as governmental policy. I match this conceptual advance with a novel empirical approach by employing latent variable models to estimate the position of the societal groups with respect to their preferences across creditors.

Incorporating these three conceptual advances – explaining the choice amongst creditors, focusing on the demand-side, and emphasizing preferences of sub-national societal groups – into a common theoretical framework represents a novel approach to the study of sovereign debt. As a consequence, my framework provides new insights into previously unresolved puzzles in the literature on sovereign debt.

For example, my theory reconciles the contradictory finding that IMF programs cause public protest and yet are frequently signed despite such protest. Vreeland (2003*b*) describes instances where political leaders sign IMF agreements despite large public protests against such agreements. Further, Sidell (1988) and Killick (1995) argue that IMF programs helped existing governments to maintain office despite instances of public protest. My theoretical framework reconciles these observations. While the minority actor – say Labor – may be in the streets protesting, I provide an explanation for why a government catering to a Capital coalition has the incentive to implement the preferred policy of Finance and Industry over Labor.

In addition, my theory provides new insights into the phenomenon of recidivism. Scholars have been puzzled by the empirical fact that a country which has received IMF loans in the past is more likely to receive an IMF loan again than a country that has never had dealings with the IMF. This so-called recidivism cannot be explained by economic factors alone as econometric studies show that the differences in probabilities persist even when controlling for economic measures. Political scientists have therefore suggested that the domestic audience costs of obtaining IMF loans with its macroeconomic conditions differ systematically across these two sets of countries. In particular, participating in IMF programs incurs so-called ‘sovereignty costs’ as the public is expected to accuse the government

of ‘selling out’ to the international institution. However, sovereignty costs decrease over time if the current government can point to previous leaders that have turned to the IMF in the past. With lower sovereignty costs, the likelihood of turning to the IMF again and again is higher than in countries that still would incur high sovereignty costs if they were to enter an IMF agreement for the first time (Vreeland, 2003a).

While this hypothesis can explain the dynamics of a country *after it has signed its first IMF agreement*, no explanation is given as to why it would ever sign an initial agreement. After all, initially, both sets of countries were identical as neither had received an IMF loan. In contrast, my theoretical framework can explain the heterogeneity in sovereignty costs across countries without reference to some exogenous shock while also explaining recidivism. The focus on the political dynamics of domestic interest groups can therefore explain what type of countries are more likely to enter into an agreement with the IMF in the first place *as well as* why they are more likely to return to the IMF over and over again.

7.2 Normative implications

Besides the academic contributions, what are the implications of my study outside of the ivory tower? Why should policy makers care about who chooses BRIC loans rather than loans from traditional creditors? My explanation for why some developing countries rely more heavily on BRIC loans than others offers insights into the likely repercussions for the countries that choose to obtain these loans. In particular, my argument suggests that BRIC loans might have unique implications for issues of power, development and democracy.

Power With respect to power, scholars and politicians alike previously assumed that granting loans to foreign countries would provide creditor countries with a degree of power over the recipient (Waltz, 1979). However, the emergence of non-traditional creditors offers developing countries the opportunity to choose among several creditors. My findings

provide powerful evidence that countries make use of this opportunity as I have shown that their choices vary.

Because of the availability of alternatives, governments in developing countries are less dependent on a traditional creditors. In other words, the emergence of BRICs as an alternative source of finance is undermining the quasi-monopoly that western creditors inherited after the collapse of the Soviet Union in the late 1980s. Instead of being ‘forced’ to resort to traditional creditors, governments now have certain room to maneuver. The availability of a creditor that offers loans to fundamentally different conditions allows countries to pursue policies that western creditors would have been unwilling to fund. It might therefore be the case that governments are now able to pursue a development path similar to that of the East Asian Tigers and contrary to the prescriptions of the neoliberal Washington Consensus. While I do not want to make a statement as to the benefits of this situation, I do recognize that the increased room to maneuver implies a higher degree of sovereignty for developing countries. Particularly in democracies, this implies that the population in these countries has gained autonomy to choose their own political course with less interference of creditors they dislike. My work therefore illuminates how globalization actually increases flexibility for small states in an increasingly globalized world.

Besides the increase in sovereignty, the availability of choices to governments implies more competition among creditors. The fact that governments have a Best Alternative To A Negotiated Agreements (BATNA) available in negotiations with a particular creditor appears to have an effect on the conditions to which loans are offered. For example, Figure 7.1 displays the effect that borrowing from BRIC appears to have on the conditions of loans that are subsequently offered by traditional creditors. For this figure, I first calculate the average interest rate of all loans obtained from the respective type of traditional creditors in the 5 years prior to the first BRIC loan of more than \$US 100 million. I then calculate the average interest rate of loans obtained from traditional creditors in the 5 years after this large BRIC loan. The figure displays the difference in the average interest loans before

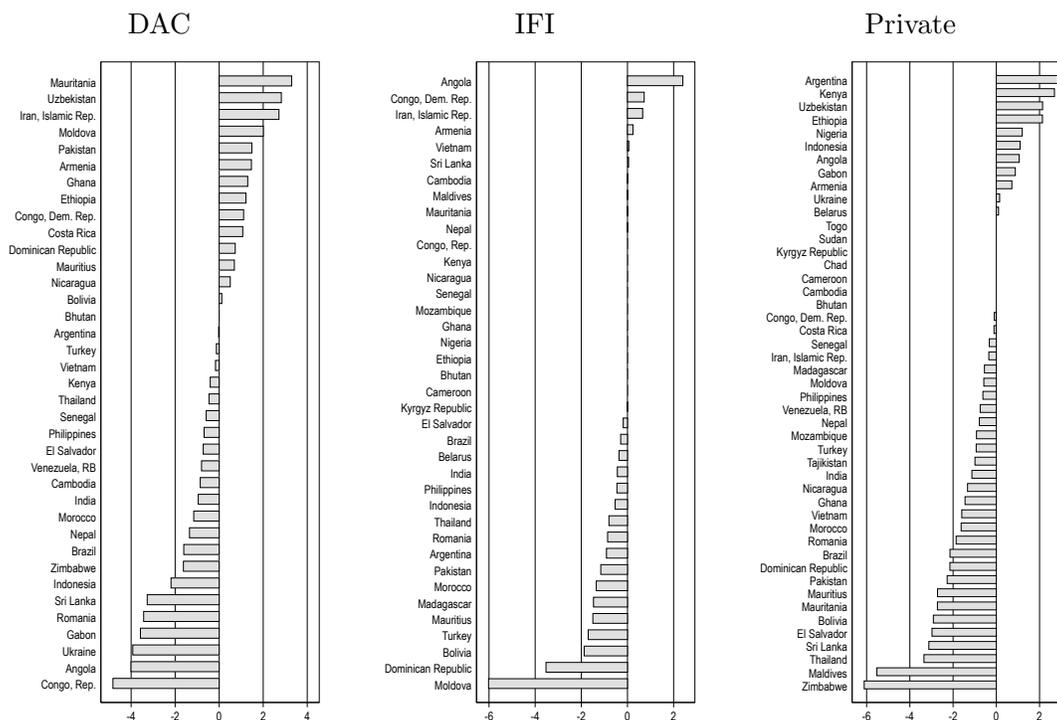


Figure 7.1: Difference in average interest rates of loans from traditional creditors obtained in the 5 years before and the 5 years after a country obtained its first BRIC loan of at least 100 million \$US.

and after obtaining a large BRIC loan. It appears that traditional creditors ‘feel the heat’ of the competition. Once governments show that they are willing to use BRICs as a source of loans, traditional creditors appear to improve the terms of their subsequent loan offers. This might imply that the emergence of BRICs might lead to a ‘race to the top,’ resulting in better lending terms for developing countries.

My research also speaks to whether the IMF will remain relevant in the near future. I have shown that certain types of countries, in particular those characterized by a Corporatist or Consumer coalition, will continuously prefer borrowing from traditional creditors instead of emerging lenders. The IMF may therefore rest assured that its services and

loans will continue to be demanded in the future, albeit only by a subset of countries.

Development Since their emergence as creditors, policy makers and development organizations alike have been concerned with the effect of BRIC loans on issues of development. Do Chinese loans assist development or do they retard growth? Figure 7.2 presents a first step towards assessing the macroeconomic consequences of BRIC loans. It compares the average GDP per capita in the 5 years prior to acquiring the first BRIC loan larger than \$US 100 million with the average GDP per capita in the 5 years after that loan has been obtained. It appears that the GDP per capita is generally not negatively affected by BRIC loans. In fact, the majority of countries exhibits higher GDP per capita in the period following the acquisition of a large BRIC loan. Nevertheless, it is worth emphasizing that these descriptive statistics are only the first step towards assessing the quantitative consequences of BRIC loans on GDP.

The insights obtained from my interviews in Ecuador, Peru and Colombia point to a qualitative dimension on which BRIC loans might have a positive impact. The conditions attached to loans from traditional creditors advance a neo-liberal concept of development by emphasizing education and health. In contrast, BRIC loans are typically associated with specific investment projects, particular in the infrastructure and transportation sector. While improving health and education is undoubtedly important, it might be that improvements in infrastructure are more efficient and effective for advancing development. According to Foster et al. (2008, p.23), the gap in infrastructure investment in African countries alone amounts to \$10 billion annually, which has been estimated to reduce Africa's GDP growth by about 1% (Esfahani and Ramirez, 2003; Calderon and Servén, 2004). Due to their different sectoral emphasis, BRIC loans might therefore help resolve a crucial bottleneck preventing growth.

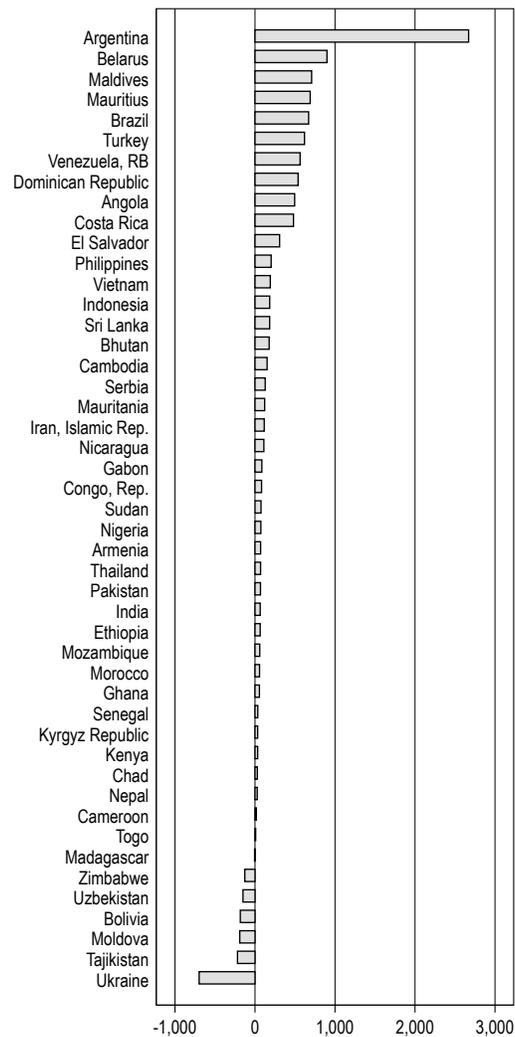


Figure 7.2: Difference in average GDP per capita in the 5 years before and the 5 years after a country obtained its first BRIC loan of at least 100 million \$US.

Democracy Besides concerns regarding the impact of BRIC loans on development, a number of observers have argued that BRIC loans might undermine democracy in recipient countries. For example, at the G8 meeting in Heiligendamm in 2007, German Finance

Minister Peer Steinbrück stated that BRIC loans undermine the promotion of ‘good governance’ by western creditors (Wenping, 2007). Others have argued that the Chinese in particular are more likely than western creditors to grant loans to non-democratic governments, thereby providing leaders with resources which allow them to remain in office longer than otherwise possible.

My study provides insights into the likely effects of BRIC loans on democracy, and they differ from this pessimistic view. My argument rests on analyzing the distributional consequences of different loans. I find that IMF loans benefit the capital owners who are already rich. In contrast, BRIC loans benefit Labor which is comprised of the poorer segments of society. Considering that BRIC loans therefore materially benefit the numerical majority, these loans might contribute to a reduction in inequality. Following Boix (2003) and Acemoglu and Robinson (2006), reducing inequality makes democracy more likely. Chinese loans might therefore have an indirect pro-democratic effect.

Preliminary analysis of the relationship between BRIC loans and democracy scores appears to support this line of reasoning. Figure 7.3 represents the change in polity scores of countries that received their first BRIC loan larger than \$US 100 million. I calculate the average polity score in the 5 years prior to receiving the BRIC loan and compare it with the average polity score of the 5 years following the acquisition of this loan. I want to emphasize that this data only represents the first step towards understanding the effect of BRIC loans on democracy. Nevertheless, it appears that there is no indication that BRIC loans might retard democracy, but rather that the opposite is the case.

7.3 Directions for future research

The analysis presented in this study has been constrained by the fact that BRIC lending is a relatively recent phenomenon. Considering the relatively short period of time in which BRICs represented a reasonable option as a source of loans for governments in developing countries, the lack of long time-series data prevents the analysis of the political dynamics

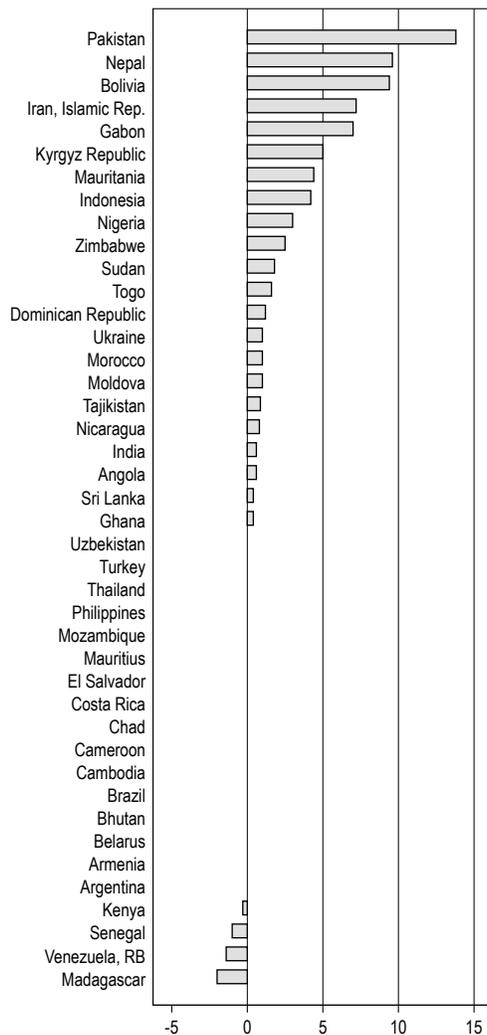


Figure 7.3: Difference in average Polity score in the 5 years before and the 5 years after a country obtained its first BRIC loan of at least 100 million \$US.

that are initiated by BRIC loans.

This study has therefore focused on the analysis of political dynamics that lead to BRIC loans. Future analysis could center on the effects that BRIC loans themselves have on the political dynamics that produced them. For example, while I have shown how certain types

of coalitions tend to borrow from BRICs while others do not, it would be worthwhile to investigate the nature of the macroeconomic consequences of these loans and how these effects shape the societal coalitions in future years. For example, it is conceivable that BRIC loans lower unemployment as they are typically tied to investment projects that typically create employment opportunities. Following the logic of Chapter 4, this would couple the positions of Labor and Industry in favor of each other, thereby cementing the likelihood of a Corporatist coalition which in turn makes BRIC loans more likely. However, such an analysis requires long time-series data that is currently not available. We will have to ‘wait and see.’

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Appendix A

Fieldwork information

A.1 List of interview partners

I interviewed a total of 112 individuals in 2011. The names of the individuals that gave permission are listed below, sorted alphabetically and by country.

A.1.1 Colombia

Álvarez, Martha Cecilia	Guarin, Maria Fernanda
Benetti, Juan Guillermo Castro	Hofstetter, Marc
Buchs, Thierry	Ibarra, Carolina
Chacón Peña, Manuel Andres	Junguito, Roberto
Concha Corzo, Angelica	Laserna, Juan Mario
Creutzfeldt, Benjamin	León, Javier
Duarte, Ricardo	Leiteritz, Ralf
Escobar Arango, Andres	Mantilla, Jaime
Fergusson, Leopoldo	Martinez, Oscar
Fernandez, Andres	Mathieu, Hans
Garcia, Juana	Mendoza de Galofre, Patricia
Gaviria Ángel, Gustavo	Montes Uribe, Enrique
Gazon, Bénédicte	Moreno Henao, Camila
	Nupia, Oskar

Peña, Angelica	Rojas Hayes, Carolina
Perry, Guillermo	Romero, Iza Fernanda
Piwek, Sonia	Salamanca, Sandra
Posada, Miguel	Sanchez, Daniela
Quan, Zhou	Steiner, Roberto
Quinones, Rocio	Suescun, Rodrigo
Ríncon, Hernan	Technical report
Reina, Mauricio	Thiell, Marcus
Rettberg, Angelika	Vargas, Camilo
Richy, Fabrice	one anonymous interview

A.1.2 Peru

Alzamora, Gonzalo Miguel Alvarez Calderon	Heller Ledgard, Vanessa
Aráoz, Mercedes	Herrera, Carlos A
Armas, Adrian	Illescas, Javier
Arteaga, Mario F	Kámiche, Joanna
Bajarano, Waldy	Kuczynski, Pedro-Pablo
Barrenechea Ch, Alvaro	Ming, Lv
Beltran, Arlette	Morón Pastor, Eduardo Andrés
Benavented, Patricia	Quevedo Ocampo, Isabel
Carbajal Vela, Liliana	Salhuana, Roger
Cooper, Claudia	Su, Adriana
Felix, Marcos	Tangri, Xiaohuan
Galarza, Francisco	Vásquez Sanabria, Fernando
Gomez Gamarra, Zoila del Rosario	von Hesse, Milton
Gonzalez Vigil, Fernando	Xiaohe, Hong
	four anonymous interviews

A.1.3 Ecuador

Abarca Runruil, Madeleine
Acosta, Alberto
Albornoz G, Vicente
Bayas Paredes, Santiago
Burbano, Gabriela
Checa, Eduardo
Detsch, Claudia
Espinoza, Carlos
Gonzalez, Jorge Luis
Jácome Estrella, Hugo
Mancero de Viterio, Piedad
Minoli, Gino
Oleas M, Sebastián
Pachano, Simon

Paredes, Pablo Lucio
Peña Villarruel, Rene
Perez, Wilson
Piedra Vivar, Pablo
Rast, Lothar
Reyes, Milton
Rodas Espinel, Armando
Rodas, Andrea
Romero, Pedro
Salgado, Wilma
Soria, Andres
Villalbo Andrade, Mateo
three anonymous interviews

A.1.4 Germany

Bartels, Matthias
Gleichmann, Colin
Kaiser, Jürgen

A.2 Interview questions

Note that I conducted semi-structured interviews. Thus, the question order and wording varied across interviews, as it was more important to have a conversation. Open-ended questions were used.

A.2.1 Questions for Recipient Government Representatives

- What is the process by which loan agreements are reached?
- What financing options does the government typically have available? Are you credit constrained?
- Are there situations in which you have to choose between offers? Have there been instances where you rejected offers?
- How do you evaluate BRIC vs. DAC vs. Multilateral vs. Private debt? Which do you prefer and why?
- Have there been Chinese loans obtained by the government? If yes, why?
- If there are none, where loan offers made? Why were they rejected?
- How do domestic constituencies think about Chinese loans? DAC loans? etc. Who benefits and who loses?
- Does it matter to your decision making process what domestic constituencies think?
- If there are losers, why does an agreement come into existence? How do losers try to prevent losing? Why do winners win?
- Why are the borrowing strategies of Ecuador, Peru and Colombia so different?

A.2.2 Questions for Representatives of Finance, Industry and Labor

- Why are the borrowing strategies of Ecuador, Peru and Colombia so different?
- Does it matter to you what type of loan the government obtains? What do you get, if anything?
- How do you evaluate BRIC vs. DAC vs. Multilateral vs. Private debt? Which do you prefer and why? What are the distributional consequences, if any?
- How do you see Chinese loans vs. Chinese investment vs. Chinese trade?
- Do you lobby the government re: the type of debt that it should obtain? If so, through which channels? Are politicians responsive?

- Have there been Chinese loans obtained by the government? Why were they accepted?
- If there are none, where loan offers made? Why were they rejected?

A.2.3 Questions for Creditor Representatives

- What is the process by which loan agreements are reached?
- Have there been Chinese loans obtained by the government? If yes, why?
- If there are none, where loan offers made? Why were they rejected?
- Is there competition between you and other creditors?
- Have there been instances where your loan offer was rejected? If so, why?
- Why are the borrowing strategies of Ecuador, Peru and Colombia so different?
- How do you evaluate the borrowing strategy by the government?

A.3 Consent Form

FORMULARIO DE CONSENTIMIENTO

¿Por qué algunos países en desarrollo solicitan préstamos a países de mercados emergentes, y otros no?

Usted está invitado a participar en mi investigación doctoral en la Universidad de Minnesota. En este estudio indago sobre las razones por las cuales algunos países deciden solicitar préstamos a los mercados emergentes como China mientras que otros países no lo hacen. Usted ha sido seleccionado como posible participante por ser un funcionario público involucrado en la decisión de solicitar préstamos o porque hace parte de los grupos de interés que pueden verse beneficiados o perjudicados si su país acepta préstamos de China. Le pido por favor que lea este formulario y me haga cualquier pregunta que tenga antes de aceptar participar en el estudio.

Este estudio está siendo realizado por:

Jonas Bunte
 Universidad de Minnesota (University of Minnesota)
 Ciencia Política (Department of Political Science)

Antecedentes El propósito de este estudio es comprender las razones por las que algunos países en desarrollo deciden pedir prestado a países de mercados emergentes (como China), mientras que otros países en desarrollo no lo hacen.

Procedimientos Si acepta participar en este estudio, se le pedirá que haga lo siguiente: La entrevista tendrá una duración de 1 hora y tendrá lugar en la sede de la institución gubernamental o asociación respectiva. Las preguntas son acerca de (1) las ventajas y desventajas de las diferentes ofertas de préstamo, (2) la opinión de los grupos de interés con respecto a las ofertas de préstamos, (3) los detalles de la toma de decisiones, (4) sus expectativas en cuanto a las decisiones sobre préstamos que su país hará en el futuro, y (5) una evaluación de la estrategia de endeudamiento de otros países.

Si está de acuerdo con la entrevista, le voy a pedir permiso para usar una grabadora una vez empecemos. Usted decide si prefiere que use la grabadora o no.

Riesgos y beneficios de estar en el estudio El estudio no tiene riesgos. No hay beneficios directos para participar en este estudio.

Confidencialidad Los registros de este estudio son privados. Cualquier tipo de informe que salga publicado no incluirá ninguna información que permita identificarlo a usted

como individuo. Los archivos de la investigación se almacenarán de forma segura y sólo el investigador tendrá acceso a los registros. Si usted acepta quedar grabado en audio, la grabación será almacenada en carpetas cifradas y será eliminada después de cinco años.

Carácter voluntario del Estudio La participación en este estudio es voluntaria. Su decisión de participar o no no afectará sus relaciones presentes o futuras con la Universidad de Minnesota. Si decide participar, usted es libre de no responder a cualquier pregunta o de retirarse en cualquier momento, sin perjuicio de las relaciones.

Contactos y preguntas El investigador de este estudio es Jonas Bunte. Usted puede hacer cualquier pregunta que tenga ahora. Si tiene preguntas más adelante, lo animo a contactar al investigador directamente en la siguiente dirección:

Universidad de Minnesota (University of Minnesota)
Ciencia Política (Department of Political Science)
1414 Social Sciences Building
267 19th Ave S
Minneapolis, MN 55455
Número de teléfono: +(001) 612 709 4242

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Si tiene alguna pregunta o inquietud con respecto a este estudio y le gustaría hablar con alguien que no sea el investigador, contacte directamente a la Línea del Defensor de los Sujetos de Investigación, D528 Mayo, 420 Delaware St. SE, Minneapolis, Minnesota 55455, (612) 625 1650.

Se le dará una copia de esta información para mantener en sus archivos.