

# Coming to Terms: The Politics of Sovereign Bond Denomination <sup>\*</sup>

Cameron Ballard-Rosa<sup>†</sup>    Layna Mosley<sup>‡</sup>    Rachel L. Wellhausen<sup>§</sup>

March 2021

## Abstract

Governments interact strategically with sovereign bond market creditors: they make choices not only about how often and how much to borrow, but also under what terms. The denomination of debt, in domestic or foreign currency, is a critical part of these terms. The “original sin” logic has long predicted that creditors have little appetite for developing country government debt issued in domestic currency. Our novel data, including bond issues by 131 countries in 240,000 primary market transactions between 1990 and 2016, suggest otherwise. Domestic-denominated bonds have come to dominate the market, although domestic currency issuance often is accompanied by shorter bond maturities. We argue that ideologically-rooted policy preferences play an important role within this unexpected trend in denomination. All else equal, right governments choose foreign denomination as a means of mitigating currency risk and thus minimizing borrowing costs. In contrast, left governments opt for the flexibility of domestic denomination, and they are better able to act on their preferences in the presence of risk-mitigating monetary institutions and macroeconomic stability. We find support for our argument that partisanship has a robust and enduring relationship with denomination outcomes, even in a marketplace in which domestic-denominated developing country sovereign bonds have become the norm.

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<sup>\*</sup>Acknowledgements: Previous versions of this paper were presented at the 2018 International Political Economy Society meeting, the 2019 DebtCon meeting, the 2019 American Political Science Association meeting, New York University, Princeton University and UC San Diego. We thank participants in those events, as well as B. Peter Rosendorff and Thomas Sattler, for comments. Robert Galantucci and Mitch Watkins assisted in compiling bond issue data; Devin Case-Ruchala and Bailee Donahue researched debt management practices; Kelly Kennedy and Benjamin Roberts helped compile credit rating and election data; and students at Innovations for Peace and Development at UT Austin researched case illustrations.

<sup>†</sup>UNC Chapel Hill, cameron.ballard-rosa@unc.edu.

<sup>‡</sup>Princeton University, mmosley@princeton.edu.

<sup>§</sup>University of Texas at Austin, rwellhausen@utexas.edu.

# 1 Introduction

In the contemporary era of financial globalization, a wide swath of countries has an unprecedented ability to issue sovereign bonds on international capital markets. In 1990, 21 non-OECD countries issued bonds in international markets; this number grew to 44 by 1995. And, in 2010, 96 non-OECD governments issued international bonds. In our issue-level data on sovereign debt, we document over 240,000 bond issues by 131 countries between 1990 and 2016. What is more, developing country sovereign issuers are not simply passive takers of supply-side capital offerings. Developing country governments make strategic choices over the timing and amount of their sovereign bond issues (Ballard-Rosa, Mosley and Wellhausen, 2019). Here, we argue that their strategic choices also concern the terms of the bond issued. These bond terms are important: they influence countries' future exposure to local and global crises, as well as to financial market pressures.

Bond terms provide governments an opportunity to trade off between borrowing costs and refinancing risks. We focus on whether governments denominate debt in their own (domestic) currency or in foreign currency. Domestic debt denomination in particular requires trade-offs that encapsulate classic ideological differences over economic policy. In brief, right governments prefer foreign denomination as a means of mitigating currency risk and thus minimizing borrowing costs, while left governments prefer domestic denomination to maximize flexibility while transferring currency risk to investors. Therefore, all else equal, we argue that left governments are more likely to issue domestic-denominated debt, even as doing so may necessitate trade-offs across other terms.

Our theoretical logic and empirical evidence highlight the agency of developing country governments to bargain over the terms of their sovereign borrowing. While it is clear that financial globalization enables these countries to access private capital markets (Bunte, 2019; Mosley, 2003; Tomz, 2007), the long-standing expectation has been that creditors largely set the terms of their borrowing. Specifically, developing countries suffer, by virtue simply of their status, from “original sin” (Eichengreen and Hausmann, 1999, 2005). As such, developing country sovereigns must issue debt in foreign currencies in order to placate investors' concerns. At the extreme, “original sin” implies that demand for domestic-denominated debt from developing countries is effectively zero. In a milder form, “original sin” suggests that creditors and debtors will not agree on bond terms with domestic denomination, because the creditors' demands on other bond terms to compensate

for domestic currency risk would be so onerous.

Strikingly, the empirical record upends these “original sin” expectations. Our issue-level data make the trend clear: 56% of non-OECD sovereign debt issued in 1990 was domestic currency-denominated, reaching 82% in 1995 and 92% in 2010. Countries including Brazil, Colombia, Venezuela, and Bolivia have in recent years refinanced outstanding foreign-currency debt to denominate in their own currencies. In the contemporary marketplace, domestic-denominated developing country sovereign bond issues have become the norm. As we note below, structural aspects of contemporary international capital markets shed some light on why “original sin” expectations have been sidelined. The global investor base has grown dramatically; many governments have worked to create or deepen markets for local currency debt; and international financial institutions have worked with developing country governments to professionalize the debt management offices (DMOs) responsible for issuing sovereign bonds. Liquid global capital markets offer opportunities, therefore, for many sovereign borrowers. Regardless, fully explaining this empirical pattern requires theoretical work to understand how creditors and debtors are frequently able to reach terms that reflect creditors’ appetite for, or at least acceptance of, domestic currency denominated debt.

Yet it would be a mistake to interpret the surge of domestic denomination as evidence that government desires to denominate in domestic currency are now costless, uncontested, or foregone. For example, a fierce debate raged in India in mid-2019, after the Indian government proposed issuing the country’s first-ever non-rupee-denominated sovereign bonds; current and past policymakers clashed over the proposal in a plethora of prominent opinion pieces in India’s major newspapers.<sup>1</sup> This contestation over debt denomination reveals the real and perceived tradeoffs that exist when governments bargain with creditors over the terms of their borrowing. While domestic currency denomination is far more available to developing country governments than it was decades ago, it nonetheless entails tradeoffs on other terms of debt, as well as on other elements of economic policy. Distributional conflict related to these tradeoffs is at the heart of governments’ currency denomination choices.

Therefore, we approach the dramatic shift in debt denomination by focusing on the role of debtor governments in bargaining over the terms of their bond issues. Many analyses of sovereign

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<sup>1</sup>We thank Vashishtha Doshi for discussions and for sharing a collection of such pieces, from sources including the Times of India, Telegraph India, The Hindu Business Line, Business Standard, The Economic Times, Mumbai Mirror, Business Today, and LiveMint.

debt focus on the supply (creditor) side of the market: investors' assessments of default risk – and their resulting offers of bond terms – vary as a function of various political institutions, macroeconomic outcomes and past outcomes (Barta and Johnston, 2018; Gray, 2013; Mosley, 2003; Mosley, Paniagua and Wibbels, 2021; Tomz, 2007). Implicit in these analyses is the assumption that developing country sovereigns have little bargaining power vis-a-vis investors; while these governments may have domestically-driven preferences over the ways in which they borrow, these preferences have scant influence over the bargains made with investors.

However, despite their apparent lack of bargaining power vis-a-vis official creditors (Stone, 2011), developing country governments often interact with multilateral financial institutions and individual donor governments in ways that reflect domestic considerations (Bunte, 2019; Copelovitch, 2010). Developing country governments may use conditional lending to tie their political rivals' hands, avoid external financing conditions that threaten their political survival, and use foreign aid revenues as a means of domestic credit-claiming (Cruz and Schneider, 2017; Vreeland, 2003).

We claim that the same pattern holds in the realm of private market sovereign bonds. Governments' preferences over economic policy, rooted in domestic politics, shape not only their demands around sovereign borrowing, but also the outcomes of their bargaining interactions with creditors. Governments' preferences regarding sovereign debt denomination fall along traditional partisan lines. Left governments especially prefer domestic denomination, which transfers currency risk to investors. This frees the government from worry about the implications of currency depreciation or exchange rate volatility for the government's capacity to repay its obligations. Investors, however, require compensation for taking on currency risk, even in the context of liquid financial markets. Indeed, using our issue-level data on currency, maturity, and yield, we find descriptive evidence consistent with costs to domestic denomination. Moreover, we find that left governments are more likely to denominate in domestic currency in the presence of domestic institutions that blunt investors' concerns over currency risk, specifically politically independent central banks or credibly fixed exchange rates. At the same time, left governments are less likely to issue in domestic currency in the context of a crisis, when investors are more sensitive to risks of holding foreign currency-denominated assets.

On the other side of the partisan divide, we find that right governments are, all else equal, less likely to denominate their bonds in domestic currency. While right governments may sometimes

employ domestic currency denomination—especially when the market-based costs of doing so are low—their ideological preferences for monetary restraint and fiscal discipline result in a favorable view of foreign currency denomination. That is, the constraints generated by foreign currency borrowing are attractive: these limit the appeal of expansionary monetary and fiscal policies, both to right governments and their successors. These systematic, partisan-based differences in the ways in which sovereigns issue bonds highlight the importance of demand-side preferences to determining outcomes in debt markets. Our logic also reinforces the notion that, despite the competitive pressures generated by economic globalization, political ideology remains an important factor in shaping governments’ policy decisions (Garrett, 1998), even in developing countries.

In the next section, we use our issue-level data to illustrate the striking trend in domestic currency denomination and situate it within broader global trends. We then develop our argument that domestic partisanship is a key, and enduring, determinant of debt denomination, even as creditors are generally more accepting of domestic currency denominated bonds. We present descriptive statistics, regression results, and robustness tests consistent with the importance of government ideology to debt denomination, across developing countries and throughout the time period. Moreover, we find that the relationship between left governments and domestic currency debt is strongest in the presence of currency-risk-mitigating politically independent central banks or credibly fixed exchange rates. In contrast, left governments are less likely to denominate in domestic currency in the context of inflation or currency crises. We conclude with priorities for future research on the domestic politics of sovereign borrowing, as well as the persistence of developing country currencies in global credit markets.

## **2 Trends in Developing Country Sovereign Debt**

While bond-based financing is not the only source of credit on which governments rely (Blommestein and Horman, 2007; Kaplan and Thomsson, 2016; Gelpern, 2018), bond issuance on international markets is a very common form of financing for many developing countries, including many that previously were able to borrow only from official sources such as bilateral creditors or regional development banks (Bunte, 2019; Zeitz, 2019). This increased access has occurred in the context of significant increases in global capital market liquidity as well as the financialization of much

economic activity (Presbitero et al., 2016; Brooks, Cunha and Mosley, 2015). Today the investor base for developing country sovereign debt spans institutional investors, hedge funds, commercial banks, foreign central banks, sovereign wealth funds, and retail investors (Chwieroth, 2009; Datz, 2008).<sup>2</sup> This growth in the number and type of creditors dovetails with contemporary demand for a wide and diversified range of investment instruments (Mosley, 2003). Moreover, many developing country governments have generated additional domestic demand for their debt instruments as a result of the privatization of their social security systems. Private or semi-private pension funds often prefer (and may be required) to hold their sovereign’s debt (Betz and Pond, 2019).<sup>3</sup>

Governments also have taken actions to increase the perceived quality of their sovereign debt offerings. In particular, the IMF, the World Bank and various regional development banks have encouraged the professionalization of the national debt management offices (DMOs) responsible for issuing and managing government portfolios. Though DMO policies have not fully converged, many developing countries now grant DMOs autonomy from elected officials and prioritize hiring staff with private sector experience (Melecky, 2007, 2012; Sadeh and Rubinson, 2018; Sadeh and Porath, 2019). More professionalized DMOs are better able to liaise with private market actors, to analyze and time the supply-side dynamics of global markets, and to learn from the issuance choices of peer countries (Brooks, Cunha and Mosley, 2015). The correlation between these risk-mitigating actions and the growth of sovereign bond-based financing suggests that developing country governments have had success in addressing concerns over default risk; while these sovereigns often borrow at higher interest rates than their OECD counterparts, they nonetheless have access to bond issuance in private capital markets.

Still, the expansion of sovereign bond markets does not in itself suggest investors have ceased to worry about currency risk. Governments face the temptation to erode the real value of debts denominated in their currency, over which they have sovereign control (Ottonello and Perez, 2019). Domestic currencies often suffer volatility as well as depreciation, especially in developing country contexts. Developing country governments that want to borrow therefore must address investors’ concerns with currency risk, labelled as “original sin” by Eichengreen and Hausmann

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<sup>2</sup>On the implications of variation in the investor base for fiscal consolidation, see Rommerskirchen (2020).

<sup>3</sup>Note that, just like foreign investors, domestic investors may hold domestic- or foreign-currency denominated debt. Countries sometimes collect information on the nationality and type of the initial purchasers of debt, but these need not reflect the ultimate bondholders after secondary market transactions.

(2005, 1999).<sup>4</sup>

A direct way for a government to overcome the original sin constraint is to tie its hands at the point of issue, by denominating its offerings in a foreign currency, over which it has no control. The borrowing government assumes currency risk; it must generate foreign exchange in order to pay back or refinance debt obligations. At its starkest, original sin predicts no possibility for developing country sovereigns to issue domestic-denominated debt. By virtue of their status, these sovereigns cannot assuage investors' concerns regarding currency risk. A more modest version of the original sin logic implies that it would be extraordinarily costly (in interest rate and/or maturity terms) for a developing country government to place a domestic-denominated bond.

In fact, our data show that these longstanding assumptions are flawed. Original sin anticipates that developing countries rarely borrow in their own currencies. But as the global market for developing country sovereign debt has grown, the proportion of domestic-denominated offerings has expanded dramatically. Figure 1 shows the explosion in the percentage of sovereign debt issued in domestic currencies, in both OECD and non-OECD countries.<sup>5</sup> Many governments have refinanced outstanding foreign-denominated debt into domestic-currency debt, including Brazil, Colombia, and Venezuela in 2006 (WorldBank, 2006). For instance, in 2010, Bolivian officials proudly reported that Bolivia had cut dollar-denominated debt to 78% from 95% in just four years.<sup>6</sup>

The boom in domestic-denominated debt and the easing of the original sin constraint partly reflect the overall growth of sovereign bond markets. Recent scholarship speaks more precisely to the determinants of this boom. For instance, in economics, Borri and Shakhnov (2018) ties demand to global liquidity; Engel and Park (2018) considers denomination and domestic economic conditions in a model of optimal monetary policy; and Ottonello and Perez (2019) argues that economic expansion and inflation stabilization in emerging markets help to account for this shift. In international political economy, Betz and Pond (2019) and Pond and Betz (2019) identify how governments can use their regulatory power to increase domestic investors' holdings of their sovereign debt; and Zeitz (2019) explores how African countries like Ghana have attracted foreign investors

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<sup>4</sup>See Aizenman et al. (2020) and Engel and Park (2018) for more on the “original sin” literature in economics.

<sup>5</sup>Figure A.10 documents that this pattern extends even to the subset of non-investment grade, non-OECD sovereigns. “Investment grade” is defined as a rating of BBB- or higher from Standard and Poor’s or Fitch; or Baa3 or higher from Moody’s.

<sup>6</sup>Brandimarte, Walter. 22 April 2010. “UPDATE 2 - Bolivia plans international bond issue by 2012.” Reuters.

into domestic bond markets.<sup>7</sup>

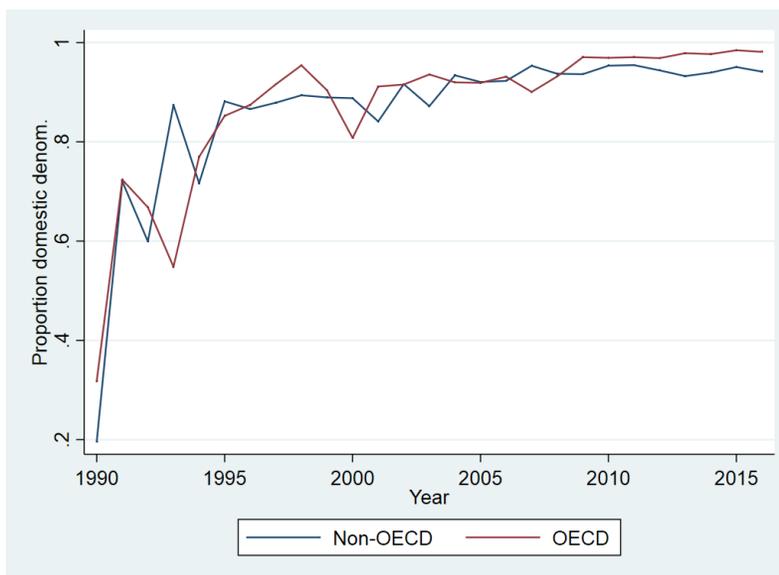


Figure 1: Proportion of domestic-currency denominated sovereign bonds.

Within this general trend, however, variation remains. Although domestic currency issuance is not only possible but quite popular, some sovereigns persist in tying their hands via foreign denomination. For example, in 2012, the relatively creditworthy government of Costa Rica chose to issue Eurobonds.<sup>8</sup> The government touted the historically low interest rate, achieved in part by denominating in foreign currency.<sup>9</sup> In 2019, Costa Rica explored refinancing some debt on more favorable terms; it again did so with foreign-denominated issues.<sup>10</sup> Also in 2019, Indian policymakers traded barbs in the press over the government’s proposal to issue foreign-denominated bonds.<sup>11</sup> According to our data, since the mid-2000s developing country debt in foreign currencies has averaged around 10 percent of all issuance (see again Figure 1).

We focus on the enduring role of politics in denomination choices: governments assign different weightings to the trade-offs between flexibility (facilitated by domestic currency issuance) and costs on other terms (specifically, maturity structures and interest rates). Because government

<sup>7</sup>Others note that, for many sub-Saharan African countries, much debt remains foreign-currency denominated, creating higher risk for debt governments. See: [www.brookings.edu/wp-content/uploads/2019/04/africa\\_sovereign\\_debt\\_sustainability.pdf](http://www.brookings.edu/wp-content/uploads/2019/04/africa_sovereign_debt_sustainability.pdf)

<sup>8</sup>Note that “Eurobond” refers to a bond which is denominated in a currency other than that used by the issuing entity. The vast majority of Eurobonds are denominated in US dollars; others are denominated in yen or Euros.

<sup>9</sup>The rate was 4.25%. Arias, L. 23 November 2012. “Eurobond sales to help Costa Rica pay down debt.” *The Tico Times*.

<sup>10</sup>“Costa Rica: Staff Concluding Statement of the 2019 Article IV Mission.” IMF. 25 February 2019.

<sup>11</sup>See again footnote 1.

preferences over these elements vary as a function of ideology, currency denomination choices therefore remain contested and politically relevant, despite broad trends in the sovereign debt market.

### 3 Theory and Hypotheses: Denomination and Partisanship

We contend that developing country governments can have significant agency in structuring credit market transactions. Empirically, we document that investors (the supply side of credit markets) are willing to accept domestic denomination (Figure 1); our theoretical expectation is that creditors use other bond terms to compensate for that choice, consistent with a weaker version of the “original sin” logic. We therefore focus our theoretical logic on the demand-side preferences of governments. Specifically, we argue that government ideology has an important influence on the ways in which developing country governments structure their interactions with sovereign credit markets. We theorize that consistent ideological preferences over denomination play a role above and beyond broader trends in international debt markets. This aligns with the empirical pattern in which investors have been willing to accept partisan differences in debt denomination.

We expect left governments to take advantage disproportionately of the market-based opportunity to borrow in their own currencies. Left governments have a well-earned reputation for decidedly distinct preferences over economic and social policy as compared to their centrist/other and right counterparts. A long literature in comparative politics roots left governments’ distinct ideological preferences in the fact that their constituents hold more of their assets in human capital (labor) than financial capital (business) (Hibbs, 1987, 1994; Alesina and Rosenthal, 1995). Risks to left parties’ core constituents stem largely from the commodification of labor and the resulting exposure to labor market disruptions (Esping-Andersen, 1990). Broadly, this results in left parties focusing on unemployment at the expense of inflation (Carlsen, 2000), and on limiting market-generated inequality (Huber and Stephens, 2012). Left parties typically prioritize providing social protection, redistributing income, and regulating industries.<sup>12</sup> Additionally, because left parties’ core constituents are less likely to be connected to globally-connected financial institutions or to

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<sup>12</sup>Adams, Haupt and Stoll (2008) attribute left parties’ consistent ideology and policy agenda in the face of changing global economic conditions to their “long-term policy orientations” and particularities of their organizational structures.

themselves invest in sovereign bonds, left governments will worry less about the potential erosion, via inflation and currency depreciation, of the real value of domestic-denominated assets.

Moreover, left governments tend to worry about the exposure to risk – for instance, to exchange rate volatility – generated by international markets. As such, left parties have been less likely to embrace financial liberalization (Li and Smith, 2002; Quinn and Inclan, 1997). Domestic currency denomination therefore reduces left governments’ worries about the potential tension between enacting their preferred macroeconomic and microeconomic policies, on the one hand, and servicing and repaying foreign currency denominated debts, on the other. Instead, domestic denomination keeps inflation in the government’s toolkit, as a potential response to high debt burdens as well as to a sluggish economy. As such, domestic denomination offers a pathway for left governments to privilege domestic, rather than foreign, objectives (Ballard-Rosa, 2020; Simmons, 1997).

Central to our theory is that left governments’ focus is on autonomy vis-a-vis market forces, as they prefer to have more options for meeting the demands of their core constituents. Much of the time, left governments do not break currency pegs or run the printing presses, eroding their money’s value. Yet they do value the possibility to do so, should domestic political or economic conditions demand it. A key observable implication of our argument, therefore, is that left governments consistently accept the costly tradeoffs (on other features of sovereign bonds) necessary to issue in domestic currency.

Put differently, supply-side creditors insist on compensation for currency-related risk.<sup>13</sup> We expect governments issuing in domestic currency to consistently settle on less favorable other financial terms, the most important of which are shorter maturities or higher yields.<sup>14</sup> Evidence of less favorable maturity and/or yield in the presence of domestic denomination matches our expectation that left governments are consistently willing to compensate investors for autonomy, whether or not they ultimately use that autonomy.

Right governments, by contrast, prefer to issue debt in foreign currency. Right parties

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<sup>13</sup>Supply-side currency risk concerns also lead us to expect that left governments are more successful at achieving domestic denomination in the presence of risk-mitigating institutions, such as an independent central bank or a fixed exchange rate, and in the absence of financial crises; see hypotheses 2, 3, and 4 below.

<sup>14</sup>For empirical support, see Table 1 below. We do not offer a theory quantifying tradeoffs across denomination, maturity, and yield in any given transaction; rather, our prediction is that evidence of tradeoffs should be recoverable from observed data.

traditionally privilege market-friendly policies, including monetary restraint, fiscal discipline, trade and financial liberalization, and respect for private property rights (Garrett, 1998; Leblang, 2002). Right parties' constituents typically are capital owners, including financial elites (Przeworski and Wallerstein, 1988). Business interests tend to welcome the opportunities for diversification and investment that come with capital account liberalization (Li and Smith, 2002; Quinn and Inclan, 1997); in contrast to left parties, they worry less about pressures on policies emanating from international markets. Furthermore, right governments are likely to have constituents who invest in government debt, and who appreciate assurances that the real value of their assets is secure (Stasavage, 2011). Moreover, right governments also may view foreign currency debt denomination as a means of tying the hands of their potential successors (Bernard, 2002). When debt stock is more foreign-denominated, subsequent governments will need to remain focused on generating foreign exchange and on preserving the value of the domestic currency. As such, right governments are relatively more willing to issue foreign-denominated debt that curtails their own access to policy instruments like inflation.

To be clear, when investors are willing to purchase domestic-denominated debt, and the costs of doing so in terms of maturity and/or yield are sufficiently low, we expect right governments to take advantage of issuing in domestic debt. In permissive market environments, right governments will not always avoid domestic denomination. This is consistent with our argument that right governments' preferences are motivated in part by the costs of domestic versus foreign denomination. Nevertheless, we contend that right governments' ideological preference for foreign denomination, all else equal, is enduring. Therefore, an observable implication of our argument is that there should exist significant differences between right and left governments' propensity for domestic denomination, controlling for global market conditions. Given the empirical trend in domestic issuance, this implies that we should recover significant left-right partisan differences in issuance throughout the time period we analyze.<sup>15</sup>

It also is worth noting that the subset of right governments which are motivated by economic nationalism may prefer domestic-denominated debt for different reasons. Economic nationalists broadly object to the notion of limiting domestic policy options vis-a-vis foreign actors including investors and intergovernmental institutions. Economic nationalist audiences may view domestic

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<sup>15</sup>For evidence, see Figure 6 and Section 5.3.1 below.

denomination as a sign of prestige or progress, consistent with the country having greater autonomy from global pressures (Harmes, 2012). Traditionally, such nationalist claims emanate from the left, consistent with our theoretical prediction regarding left preferences. However, in recent years especially, such claims have emerged from the far-right end of the political spectrum. For example, in the 2019 debates in India over the (right) Modi government’s proposal to issue foreign-denominated sovereign bonds, actors from the far-right joined leftists in decrying the proposal in economic nationalist terms.<sup>16</sup> Empirically, as our data ends in 2016, we are able to exclude the most recent far-right phenomenon. Theoretically, we contend that economic nationalism does not systematically characterize right governments worldwide – our actors of interest – or right parties in general.<sup>17</sup>

Additionally, our arguments that ideological preferences over debt denomination are meaningful and enduring for parties on the left and the right assume that, at the level of mass politics, voters broadly recognize partisan ownership or “clarity of responsibility” over different economic issues (Parker-Stephen, 2013), and that party leaders craft their economic policy choices with an eye to winning the support of certain constituencies, such as labor or capital (Bisgaard, 2015). We acknowledge that not all developing countries that issue bonds in global markets are characterized by high levels of political competition. In less competitive systems, elite-level competition is most important (Bueno de Mesquita et al., 2005); different swaths of the selectorate are likely to align with left versus right political parties. Persistent elite-level ideological differences mean that, even without mass-level partisan contestation, our partisan-based theory of preference over denomination should generate distinct market outcomes.

Lastly, our theory carries implicit expectations about centrist parties and parties that do not fall neatly on the traditional left-right spectrum with reference to economic policy. In emphasizing the enduring preferences of left and right governments, we imply simultaneously that denomination preferences are not *ex ante* clear, meaningful or enduring for governments of centrist or other orientations. As such, our expectations of left and right governments should hold with regard to centrist and/or other parties as the excluded category.

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<sup>16</sup> From the far-right RSS: “[The RSS] said it was anti-patriotic as it could create long-term risks for the economy, potentially allowing rich foreign nations and their financial institutions to dictate the country’s policies.” “RSS Wing Calls on Govt Not to Issue Foreign Currency Bonds.” Reuters. 16 July 2019.

<sup>17</sup>Should it come to do so, our theoretical expectations regarding rightist preferences be complicated. Even bigger would be the challenge to political science as a whole regarding the key drivers of rightist economic policy.

**Hypothesis 1** *All else equal, a right government is least likely to denominate sovereign debt in domestic currency, while a left government is most likely to denominate in domestic currency.*

Our expectations regarding left and right governments are premised on the assumption that governments vary, and continue to vary, in their ideological predispositions and their resulting policy choices. This assumption is consistent with scholarship which argues for the continued relevance of partisanship, despite economic globalization. It is in tension, however, with other scholarship which posits that market pressures forestall left governments' ability to enact their preferred economic policy outcomes. In fact, both strands of scholarship inspire our next set of hypotheses concerning the conditional effects of supply-side creditors' preferences on the likelihood that left governments issue in domestic currency.

On the one hand, a large body of scholarship finds significant evidence that partisan positions on economic policy are important (Campello, 2015; Kurzer, 1993; Mosley, 2003; Pinto, 2013). In general, left governments are less inclined to engage in financial liberalization (Brooks and Kurtz, 2007; Chwioroth, 2007; Li and Smith, 2002).<sup>18</sup> Left governments are also associated with higher sustained increases in public investment (Gupta, Liu and Mulas-Granados, 2015), as well as with higher levels of spending in response to crises (Muller and Zilibotti, 2016). And even when countries have signed preferential trade agreements, newly-elected left governments often impose new barriers to trade (Gray and Kucik, 2017). These distinctive policies appear in both developed and developing countries. In Latin America, for instance, left governments are more likely to pursue policies which seek to blunt rising inequality (Huber and Stephens, 2012). On the other hand, another body of scholarship argues that financial liberalization and the attendant possibility of capital flight greatly constrain the capacity of left parties to "act left" once in office (Garrett, 1998). This research contends that private markets are averse to the arrival in office of left-leaning political parties (Cho, 2014; Kaplan, 2013). They may worry that left candidates would change investment policies, tax rates, public spending or existing contractual commitments (Jensen and Schmith, 2005; Pinto, 2013). Left governments could face additional pressure from international financial institutions to maintain or implement neoliberal, Washington Consensus-style policies (Nelson, 2014). Left governments therefore could run on leftist economic policy platforms, but once in office

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<sup>18</sup>Historically, left governments have been less inclined to privilege external commitments, such as the commitment to a fixed exchange rate, over the capacity to intervene in the domestic economy (Simmons, 1997).

find compelling incentives to adopt more centrist- or right-leaning policies (Campello, 2015; Stokes, 2001). Left governments without access to alternative financing sources, such as rents from natural resources (Campello, 2015; Wibbels, 2006), may be especially exposed to market pressures.

This debate over whether or not left governments are able to “act left” plays out in analyses of the politics of sovereign debt. Some work identifies a significant role for partisanship in credit ratings and secondary markets. Barta and Johnston (2018) find that credit ratings agencies award lower sovereign ratings to left-governed countries, all else equal. Vaaler, Schrage and Block (2006) argue that investors use partisan cues as a shortcut when assessing political risk; increased bond spreads and capital flight occur when the government swings significantly away from conservative incumbents.<sup>19</sup> And in an analysis including a range of developing countries, Brooks, Cunha and Mosley (2019) find that bond markets react to left governments via greater volatility in sovereign spreads.

In contrast, Ballard-Rosa, Mosley and Wellhausen (2019) find no effect of partisanship on a crucial set of outcomes in primary capital markets: the amount of sovereign debt issued by developing countries, and the timing of those issues. Ballard-Rosa, Mosley and Wellhausen (2019) identify changes in supply-side market appetites for sovereign risk as key to the allocation of available credit. Specifically, the long-discussed “democratic advantage” in sovereign debt markets is contingent on the salience of sovereign risk to creditors.<sup>20</sup> When investors are motivated to seek out safer assets, developing country democracies gain an advantage over non-democracies in issuing more sovereign debt, more often. However, holding the level of democracy constant, there is no significant difference in the amount and timing of debt issued by governments of different partisan orientations. This non-result regarding partisanship is consistent with the strand of literature finding that macro-policy pressures from investors can constrain left parties from “acting left” once in office. Although left governments have an underlying, demand-side preference for fiscal flexibility and expansion, they nevertheless have difficulty achieving it by issuing more debt more often. In contrast, our theory posits that left governments will find it much easier to achieve their

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<sup>19</sup>While this research finds stock market reactions to partisan shifts, Frot and Santiso (2013) do not.

<sup>20</sup>Secondary-market scholarship suggests, among other things, that sovereign risk is shaped by global market conditions (Bauerle Danzman, Winecoff and Oatley, 2017; Rey, 2013; Spanakos and Renno, 2009; Wellhausen, 2015); peer group heuristics (Brooks, Cunha and Mosley, 2015; Gray, 2013); central bank independence (Bodea and Hicks, 2015, 2018; Johnson, 2016); regime type (Beaulieu, Cox and Saiegh, 2012; Schultz and Weingast, 2003; Saiegh, 2005; North and Weingast, 1989); and elections (Bernhard and Leblang, 2006; Campello, 2014; Mosley, 2003).

preferences for fiscal flexibility by choosing domestic denomination, so much so that we expect to recover systematic, partisan empirical patterns regardless of market conditions. Indeed, sovereign borrowers with similar overall debt burdens and similar macroeconomic fundamentals often exhibit marked variation in the currency denomination, maturity structure, and yield profile of their debt.<sup>21</sup>

At the point of issue in primary capital markets, creditors and sovereign debtors agree on the terms (denomination as well as yield and maturity) of a specific sovereign debt instrument. This outcome represents the intersection of government demand for and investor supply of debt. On the demand side, it reflects the government’s willingness to agree to a set of terms, in exchange for the extension of credit. On the supply side, it reflects investors’ assessment of country-specific and global risk factors, again in the context of a specific set of bond terms. Our overall contention is that creditors are often willing to accept a set of terms that reflects distinctively partisan preferences, specifically over debt denomination.

Investors’ willingness to accept domestic denomination, however, is not unlimited. Supply side-concerns about sovereign risk – including the worry that governments will erode the value of domestic currency instruments via inflation – remain. Hence, investors require compensation for the added risk associated with partisan-based demands for domestic currency issuance. The need to offer compensation suggests that a weak form of the “original sin” logic persists, even in a marketplace in which investors have an appetite for domestic-denominated sovereign debt instruments. Indeed, our arguments regarding partisan differences rely on the premise that issuing domestic is not costless, and that investors require compensation for its added risk. While we have emphasized that compensation to investors can occur via other financial terms of a bond issue, specifically its maturity and/or yield, bonds also vary in their non-financial terms. For instance, some bonds have collective action clauses, intended to simplify restructuring in the case of a default (Weidemaier and Gulati, 2016). Bonds also vary with regard to their governing law (which could be domestic or that of a major market, such as London or New York) and their exchange listing. Although our issue-level empirical data do not cover non-financial terms, our argument implies that sovereign risk can further be addressed via tradeoffs across such non-financial terms at the point of issue.<sup>22</sup>

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<sup>21</sup>For example, Cox and Saiegh (2018) identifies that otherwise identical bonds issued by Argentina in advance of the Baring crisis demonstrated markedly different price trajectories as a function of the funded status of the instrument.

<sup>22</sup>Chamon, Schumacher and Trebesch (2018) find evidence that, in secondary markets, foreign-law bonds carry

Moreover, governments may compensate investors for currency risk via mechanisms beyond bond terms (financial or otherwise). For example, governments might aim their offerings at different segments of their potential investor base, varying the denomination of their offerings as investors' time horizons or currency exposure vary. Governments also might use regulatory requirements or tax incentives to convince investors to hold their bonds (Betz and Pond, 2019). Alternatively, governments might seek some credit outside private bond markets, from private commercial banks, bilateral official creditors, or international financial institutions (Arias, Mosley and Rosendorff, N.d.; Bunte, 2019; Zeitz, 2019); these creditors may demand compensation that is political or diplomatic, rather than explicitly economic.<sup>23</sup>

We focus on the risk-mitigating effects of politically independent monetary institutions as well as by fixed exchange rates. Such institutions enhance governments' monetary policy credibility, reducing demand-side risk concerns. Their presence can therefore facilitate domestic currency issuance. As such, sovereign borrowers that prefer domestic denomination – that is, left governments – should be better able to find willing creditors in the presence of such institutions. First, politically independent central banks are one mechanism that constrains politicians' ability to act in ways contrary to market preferences. We follow a long literature suggesting that central bank independence may limit the capacity for political leaders to intervene in the macroeconomy in politically-expeditious but economically-damaging ways (Barro and Gordon, 1983; Bodea and Hicks, 2018; Clark and Hallerberg, 2000; Franzese, 1999; Garriga and Rodriguez, 2019; Maxfield, 1997). With an independent central bank, typically mandated to attend to inflation (sometimes in balance with other goals like employment or economic growth), investors should have more certainty that a left government will not inflate away the value of domestic-denominated bonds. Thus, central bank independence (CBI) should help facilitate left governments' ability to issue domestic-denominated bonds.

**Hypothesis 2** *Left governments are more likely to denominate sovereign debt in domestic currency when the central bank is more independent, as opposed to less independent.*

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lower yields especially in times of crisis. See also (Bradley, De Lira Salvatierra and Gulati, 2016).

<sup>23</sup>The capacity of non-OECD governments to choose among a portfolio of potential creditors exists more generally during recent decades, and it is especially pronounced when global liquidity is high, underscoring the importance of our empirical attentiveness to time-related and global market dynamics (Ballard-Rosa, Mosley and Wellhausen, 2019; Brooks, Cunha and Mosley, 2015; Miranda-Agrippino and Rey, 2015).

A fixed exchange rate is another mechanism that can address investors' concerns that the real value of a domestic currency bond at maturity will be significantly less than its nominal value at issue. A country with a commitment to a fixed exchange rate, generally tied to a major trading partner or source of capital, can generate greater confidence among bondholders regarding the future value of the asset.<sup>24</sup> Such an institution also should make it easier for left governments to place domestic-denominated debt. That is, fixed exchange rates facilitate the supply-side dynamics which allow left governments to achieve their partisan-based preferences.

**Hypothesis 3** *Left governments are more likely to denominate sovereign debt in domestic currency when the exchange rate is fixed rather than flexible.*

Lastly, investors become more averse to risk – and therefore less willing to purchase riskier assets like domestic-denominated bonds – in the face of inflation or currency crises. Left governments in particular will find it difficult to convince investors of their commitment to preserving the value of domestically-denominated assets, given their well-known policy preferences that do not prioritize investors' interests. We therefore anticipate that, in periods marked by the current or recent occurrence of currency and inflation crises, left governments will be less likely to engage in domestic currency debt denomination.<sup>25</sup> This is not because crises change left governments' underlying preferences, but rather because supply-side concerns are severe enough to swamp demand-side effects.

**Hypothesis 4** *Left governments are less likely to denominate sovereign debt in domestic currency when the country experiences a monetary crisis, as opposed to non-crisis conditions.*

Our first hypothesis focuses on the agency of governments to influence the ways in which they access sovereign credit. We expect, unconditionally, that left and right governments will act in significantly different ways. The remaining hypotheses highlight the role of investors' risk perceptions. These expectations are conditional, and they apply to left governments rather than to governments elsewhere on the ideological spectrum. Since we expect that right governments

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<sup>24</sup>Mitchener and Weidenmier (2015) find that in the pre-World War I era, adherence to the gold standard was associated with significantly lower risk premiums for core countries. In peripheral countries, however, gold standard adherence did not necessarily lower risk premiums, even many years after gold standard adoption.

<sup>25</sup>Cox and Saiegh (2018) also emphasize the importance of considering differential market facilitation of bond issuance in crisis episodes.

are already inclined to market-friendly policies and the use of foreign currency issuance, we do not have strict expectations regarding a further conditional effect of supply-side considerations on right governments' denomination outcomes.

## 4 Empirical Strategy

To test these hypotheses, we analyze a new dataset of the terms of approximately 240,000 initial sovereign issues in primary capital markets by 131 countries from 1990-2016.<sup>26</sup> Our dataset covers the effective population of (non-US) sovereign bonds issued on international markets. Given that currency risk in wealthy countries is of limited concern to bond investors (Mosley, 2003), and that the claim regarding “original sin” refers to the developing world (Eichengreen and Hausmann, 2005), we analyze the set of non-OECD countries that have issued bonds in the period.

The primary market – the point at which sovereign borrowers and creditors come to agreements on the terms of bond issues – is the setting in which we can observe governments' current preferences over debt denomination. Each bond issue represents a transaction in which sellers (borrowing governments, often with assistance from financial sector underwriters) and buyers (investors) agree on issuance, regarding both amount and terms. Our issue-level data includes information on bond denomination, maturity, and yield (interest rate). Note that our observational data do not allow us to observe a government's ideal point or requests with respect to terms; instead, we observe where government preferences intersect sufficiently with market demands to enable an issuance to occur.<sup>27</sup> Following our hypotheses, our statistical analyses assess not only what relationship, if any, partisanship has with outcomes in primary bond markets, but the extent to which outcomes are conditioned by market expectations over future behavior as a function of political institutions and financial crises. Our statistical models further account for supply-side dynamics by including as control variables a set of features typically associated with bond market outcomes.

A common distinction in categorizing sovereign instruments separates “bills,” generally issued with a maturity of less than one year, and “bonds,” with maturities of one year or more. Governments typically issue bills to facilitate short-term debt rollovers, and it is less obvious whether

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<sup>26</sup>Data were gathered from Bloomberg terminals. We assume that any missing data are as-if randomly distributed. We exclude countries with populations less than 100,000, as well as the United States, as the role of the dollar and the depth of the US market makes the US a significant outlier in many dimensions of issuance.

<sup>27</sup>All issues in the data are successful in that they are fully placed with investors.

these types of liquidity operations should be subject to political considerations over currency denomination, as investors are likely less worried about wild fluctuations in exchange rates over quite short time periods. In the longer term, flexibility versus cost trade-offs are more consequential, as governments face higher likelihoods of inflationary pressure and investors are more concerned with currency fluctuation and depreciation. Therefore, we estimate our main models using the subsample of all bonds issued with a maturity greater than or equal to one year; all main results are robust to using the full sample of all issues, regardless of maturity.<sup>28</sup>

We conduct our analyses at the country-month level.<sup>29</sup> Our main dependent variable is the percentage of the value (amount) of a sovereign’s bonds issued in the country’s domestic currency, collapsed by country-month. This measure captures all bonds issued in the currency within the control of the sovereign issuer. For instance, issuance by the Ugandan government in Ugandan shillings is categorized as domestic denomination, whereas issuance in any other currency (whether dollar, euro, yen, or another currency) is classified as foreign-denominated.<sup>30</sup>

Our main political covariate of interest is government partisanship, both unconditionally and as affected by economic institutions and crisis environments (Hypotheses 1–4). We rely on standard, widely-available measures of government partisanship, which allow us to test our hypotheses for a broad set of non-OECD countries. Our main measure of executive partisanship comes from the Database of Political Institutions (DPI). Per the DPI codebook, party orientation is coded relative to economic policy, which is the appropriate focus for our setting. Following standard practice, we separate governments characterized as “right,” “left,” or “centrist/other.”<sup>31</sup> This trichotomous division of governments allows us to evaluate empirically whether partisanship on the left or the right correlates with systematically different outcomes, relative to the excluded category of centrist/other governments. To complement our monthly data on bond denomination, we update these annual data on government partisanship to the monthly level, using data on

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<sup>28</sup>As reported in Appendix Tables A.9 and A.10.

<sup>29</sup>This is consistent with the unit of analysis in Ballard-Rosa, Mosley and Wellhausen (2019), which demonstrates a strong empirical correlation between overall amount issued and the number of months with issuances in a given country-year.

<sup>30</sup>Our argument turns on whether the sovereign has control over the currency or not; thus, the identity of the foreign currency is irrelevant. US dollars are the dominant foreign currency choice throughout the period.

<sup>31</sup>Left parties are those identified as communist, socialist, social democratic, or otherwise left. Right parties are conservative, Christian democratic, or otherwise right. We place parties for which the platform does not focus on economic issues (coded 0) in the centrist/other category (Cruz, Keefer and Scartascini, 2018), although our main results are robust to instead dropping these observations entirely.

precise dates of electoral turnover.<sup>32</sup> To maximize data coverage, we first estimate models with the full sample of countries for which the DPI codes government partisanship. We subsequently re-estimate our primary models on democratic and non-democratic subsamples, under the expectation that government partisanship may be more informative in more democratic countries, and given the extensive literature on the advantages that democracies enjoy in accessing international credit markets (Schultz and Weingast, 2003; Beaulieu, Cox and Saiegh, 2012; Biglaiser and Staats, 2012).<sup>33</sup>

Our other covariates of interest include central bank independence (CBI), which we dichotomize into those above or below the sample median level of CBI (Hypothesis 2).<sup>34</sup> We also code whether the exchange rate is pegged (Hypothesis 3). In order to identify countries facing crisis environments, we include a dummy that equals 1 if the country is facing an ongoing inflation crisis, and a dummy that equals 1 if the country is currently facing an exchange rate crisis (Hypothesis 4).

Given the observational nature of our data, it is important to account for additional factors that might plausibly be correlated both with the currency composition of debt issued in a country-month as well as with the partisan orientation of government.<sup>35</sup> We begin by including a set of baseline macroeconomic controls commonly associated with borrowing capacity, including GDP per capita and GDP growth, to capture the possibility that economic trajectories might vary with government partisanship. In addition, if left governments prefer to engage in more expansionary spending, there could be consequences for the market’s tolerance for government bond terms. This leads us to control for the amount of existing external debt (% of GDP) and the current account balance (% of GDP). To account for the possibility that access to alternative sources of international capital could vary with government partisanship, we control for trade (% of GDP), oil rents (% of GDP), and foreign direct investment (FDI) inflows (% of GDP).

Beyond this baseline set of covariates, we subsequently introduce a fuller set of controls that also might plausibly be jointly related to government partisanship and bond terms. The

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<sup>32</sup>The date on which the new government comes to power marks the beginning of the government’s ability to issue debt; the (previous) election date is not relevant in our setting.

<sup>33</sup>Below, we also demonstrate the robustness of our results to alternative codings of partisanship and democracy from the Varieties of Democracy (VDem) project.

<sup>34</sup>Calculated from the weighted measure in Garriga (2016). Data sources for all variables are provided in Appendix Table A.1.

<sup>35</sup>Consistent with standard practice, all controls are measured annually unless otherwise specified.

inclusion of these additional variables, however, leads to non-trivial reduction in our sample size. First, beyond the monetary crisis variables we prioritize in hypothesis testing, it may also be that countries currently experiencing a sovereign debt crisis find it harder to choose domestic denomination if the prospect of default makes investors shy away from any other risky term; if government partisanship also affects the likelihood a country is in a crisis, lack of controls for these factors might result in omitted variable bias. We therefore include dummies for current sovereign debt crises, as well as a dummy for the presence of an IMF program, the terms of which could be biased in favor of right governments (Nelson, 2014). We also include a measure of capital account openness, addressing the possibility that left governments are more likely to engage in restrictions on the capital account (Chinn and Ito, 2006; Quinn and Inclan, 1997). We furthermore control for democracy with a continuous measure (VDem’s “polyarchy” score), and probe potential heterogeneity by regime type in the robustness tests below. All specifications include country fixed effects to capture country-specific, non-time-varying determinants of our outcomes of interest.

Perhaps the most important tasks in our empirical strategy are to account for the dramatic secular increase in the number of developing country bond issuers and in the proportion of domestic currency issuance over our period. We must address changes in the sovereign debt marketplace generally, before isolating the persistent role of partisan factors. Indeed, recent work on the tolerance of bond investors for country-level politics emphasizes that the international yield environment plays an important role (Ballard-Rosa, Mosley and Wellhausen, 2019; Borri and Shakhnov, 2018). To account for the possible effect of global capital cycles on our results, we also include in our baseline controls a monthly-varying measure of the interest rate on 10-year US Treasury bonds, which are generally taken as the world’s least-risky asset.

To capture possible secular movements in our data, we introduce to all specifications a cubic polynomial in time (Carter and Signorino, 2010).<sup>36</sup> To address simultaneity bias, we lag all right-hand side measures by one year (as these data vary at the annual level), save our monthly measures of partisanship and the US 10-year Treasury interest rate, which are lagged by one month. Finally, note that our outcome of interest (% domestic issuance) is only observed in country-months in which issuance actually occurs; when no issuance takes place, we cannot measure the proportion of

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<sup>36</sup>In alternative specifications, in order to remove the effect of any shared commonality in currency issuance across all countries within a given year, we have replaced this time trend with year fixed effects; our primary results are not sensitive to the exclusion of either the temporal cubic polynomial or the inclusion of year fixed effects.

debt in a given currency, and so treat these as missing. Therefore, while we use OLS with standard errors clustered by country as our baseline estimation method, as discussed in Appendix A.6 our results are robust when we employ a Heckman selection model to account for the possibility of selection bias in months in which issuance occurs.<sup>37</sup>

## 5 Results

In this section, we present descriptive evidence consistent with our argument and its implications; report results supportive of our Hypotheses 1–4; and report robustness analyses and extensions.

### 5.1 Descriptive Preliminaries

We begin by verifying that patterns in our data are consistent with the logic of our arguments. First, our claims regarding partisanship rest on the notion that, while “original sin” no longer precludes the issuance of domestic-denominated bonds, these instruments nonetheless carry significant currency risk for investors. As such, developing country governments should compensate investors, in some way or another, for taking on these risks. The clearest and most direct means of doing so is via the other terms of the bond. Our issue-level data allow us to examine maturity and interest rate (often called the “coupon” for bonds), two key terms of any bond, sovereign or otherwise. We expect that domestic denomination requires issuers to trade off by offering shorter maturities and higher yields.<sup>38</sup>

Table 1 explores this expectation via OLS regressions of the percent of domestic currency issuance (by month) on the average maturity and interest rate of sovereign bonds issued (by month), including our full set of controls.<sup>39</sup> Note that choices over denomination, maturity, and interest rates are made at the same time; these regressions only explore associations and cannot be interpreted with reference to causality. We do indeed find domestic denomination to be significantly correlated

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<sup>37</sup>Note that, per Ballard-Rosa, Mosley and Wellhausen (2019), there is no evidence of systematic partisan differences in terms of timing or amount of issuance, so we expect these problems to be of limited concern.

<sup>38</sup>Debt instruments with shorter maturities typically present less risk to investors, as they need only worry about government ability and willingness to repay over the term of the issue. Shorter maturities, however, heighten risks for borrowing governments, as governments must more frequently return to capital markets to rollover their debt. Longer time to maturity insulates governments from the need to refinance debt earlier and more frequently.

<sup>39</sup>Monthly averages are the more appropriate unit of analysis than the issue-level terms, because DMOs can package a set of near-simultaneous individual issues that, taken together, provide compensation. One creditor can therefore receive compensation by buying the whole package. As our data do not record the initial buyer, the monthly average allows us to best account for this phenomenon.

with shorter average maturities (columns 1 and 3), as should be expected if investors would tend to prefer to hold debt with shorter maturities in exchange for allowing governments to issue bonds in their own currency. Additionally, while when entered by itself the interest rate does not appear to be systematically associated with currency denomination (as shown in column 2), when entered jointly with maturity we recover a positive and statistically significant association between the average coupon (interest rate) charged on bonds a county issues and proportion of this debt issued in domestic currency. This positive association between interest rates and domestic currency issuance is consistent with a view that investors are likely (once maturity is taken into account) to charge governments an interest rate premium for the implied risk of holding domestic-currency debt. These associations between denomination, maturity, and interest rates provide *prima facie* evidence that domestic denomination carries costs with regard to other financial terms, which increases the plausibility of our argument that choosing it is a strategic decision.<sup>40</sup> We leave the development of a theory of how DMOs optimize across denomination, maturity, and yield for future research.<sup>41</sup>

Debt terms (1990-2016)

VARIABLES	(1) % Domestic	(2) % Domestic	(3) % Domestic
Average maturity	-0.019*** (0.003)		-0.020*** (0.003)
Average coupon		0.000 (0.003)	0.005** (0.002)
Baseline controls	✓	✓	✓
Full controls	✓	✓	✓
Observations	8,187	8,187	8,187
R-squared	0.146	0.087	0.149
Number of countries	79	79	79

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

Table 1: This table reports results of OLS regressions of domestic currency issuance (by month) on alternative terms of bonds (by month), as well as a set of control variables defined above. Country fixed effects are suppressed, as is a cubic polynomial in time.

<sup>40</sup>In their recent analysis of eight emerging market countries, Aizenman et al. (2020) similarly find that domestic currency bonds tend to have shorter maturities, as well as to be smaller in size and have a lower coupon rate than foreign currency bonds. See also Arellano and Ramanarayanan (2012).

<sup>41</sup>As a preliminary exercise, we do not find that these tradeoffs across maturity, interest rates, and currency denomination vary by decade in our panel, as could arise if DMO professionalization systematically altered market tolerance of these tradeoffs over time.

Before moving to test our primary hypotheses, we also re-emphasize that while interest rates, denomination and maturity are key bond terms, bonds also vary in their non-financial terms. Unfortunately, because the Bloomberg information on which our dataset is based often does not report these non-financial terms – reporting governing law for only twenty percent of our observations, for instance – we are unable to systematically assess their relationship with denomination. Nonetheless, our argument implies that, in addition to the relationships between financial terms shown in Table 1, sovereign risk could be addressed via tradeoffs across non-financial terms (Chamon, Schumacher and Trebesch, 2018; Bradley, De Lira Salvatierra and Gulati, 2016). Moreover, governments may compensate investors for currency risk via mechanisms beyond bond terms (financial or otherwise). Our conditional Hypotheses 2 and 3 postulate that domestic economic institutions – specifically, central bank independence and a fixed exchange rate – can have such compensatory effects.

Next, for partisanship to be consequential for the choice of domestic denomination as we predict, it would be problematic if left governments in developing countries simply issued more sovereign bonds altogether. Figure 2 shows that, if anything, right governments issue a larger amount of debt through sovereign bonds, while center governments issue roughly the same amount as left governments. However, this difference in amount issued across partisanship does not remain a significant determinant of the amount of debt issued (as a % of GDP, by country-month) in a multivariate regression framework.<sup>42</sup> Thus, while left governments might generally be associated with expectations of higher debt levels, they are not systematically acquiring more debt via sovereign bond issues on international markets.

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<sup>42</sup>See Appendix Table A.3. See also Ballard-Rosa, Mosley and Wellhausen (2019).

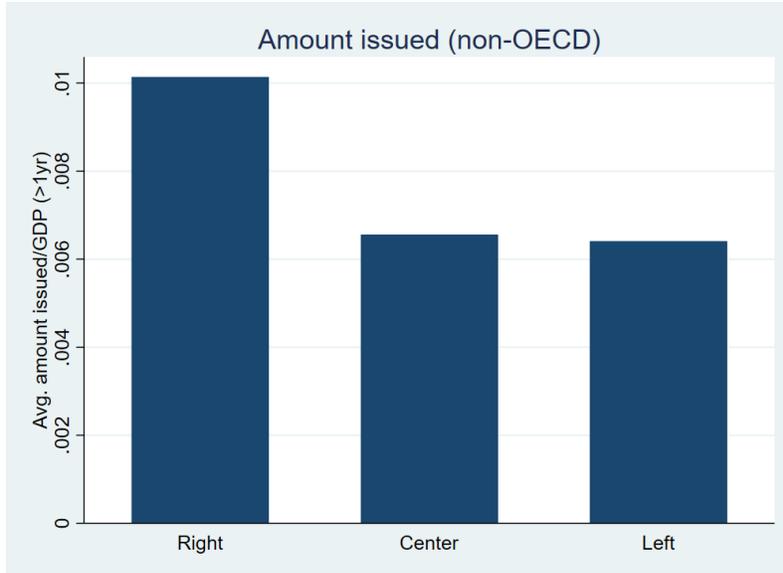


Figure 2: Average amount of sovereign bond issuance (% GDP, monthly) for non-OECD countries.

Furthermore, our argument about partisanship would be less credible if the proportion of left, right, or center parties in non-OECD countries changed radically over the period. Figure 3 shows that this is not the case. Even with phenomena like the mid-2000s “Pink Tide” in Latin America, the proportion of left and right governments has remained relatively stable, and interestingly relatively balanced, over this period, with both slightly declining in recent years. If anything, these data suggest rather the growth of centrist/other governments in recent years. These trends also increase our confidence that our measure of partisanship is not obviously biased toward attaching our specific, economic partisan preferences of interest to too many rather than too few governments.<sup>43</sup>

<sup>43</sup>Figures here are based on our main DPI partisanship measure; in the VDem measure of partisanship we use as a robustness check below we similarly do not find evidence of an overwhelming shift towards one end of the ideological spectrum over our time period.

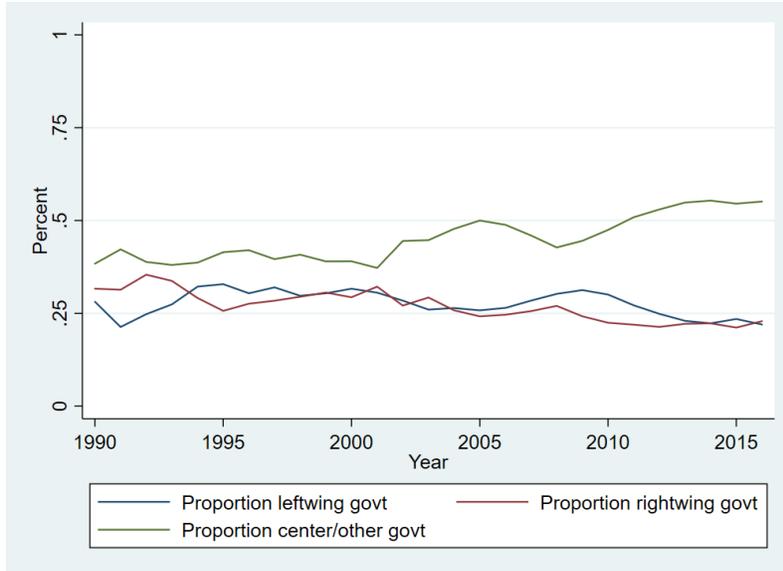


Figure 3: Proportion of governments, by ideology, 1990-2016.

## 5.2 Hypothesis Testing

Table 2 reports results evaluating Hypothesis 1, that left (right) governments unconditionally issue a greater percentage of domestic (foreign) denominated sovereign bonds. First, column 1 reports results from a simple bivariate regression, in which we find that left governments are associated with a significantly greater share, and right governments a significantly smaller share, of bonds issued in domestic currency relative to the excluded category of center/other governments. Column 2 confirms that this relationship holds when we include our baseline controls, and column 3 reports support when including other covariates of interest.<sup>44</sup> The partisan differences we detect in domestic debt denomination appear to be a function of both left and right ideologies (Hypothesis 1). That is, right governments also appear to be acting on their distinct preferences over denomination even in a permissive marketplace, relative to centrist/other governments.

Next, we evaluate the effects of partisanship conditional on other covariates that can affect investors' evaluations of governments' propensity to maintain the value of domestic-denominated debt and, therefore, investors' exposure to currency risk. Figure 4 reports differences in currency of issuance across government partisanship when interacted with a dummy for high central bank

<sup>44</sup>Note that, in moving from column 2 to 3, we lose eight countries and nearly 3,000 observations; additionally, annual data end here in 2012 due to lack of more recent data for several covariates. Interestingly, very few of the other included covariates appear systematically related to currency of issuance.

Domestic currency bond issuance (1990-2016), Non-OECD countries

VARIABLES	(1) No controls	(2) Baseline	(3) Full controls
Right govt.	-0.069* (0.036)	-0.066* (0.034)	-0.071** (0.032)
Left govt.	0.087* (0.046)	0.092** (0.045)	0.111*** (0.041)
GDP per capita		-0.017 (0.049)	-0.026 (0.048)
GDP growth (annual %)		0.003 (0.002)	0.002 (0.002)
External debt (% of GDP)		0.001 (0.001)	0.001 (0.001)
Current account balance (% of GDP)		0.001 (0.002)	0.003 (0.003)
Trade (% of GDP)		0.001 (0.001)	-0.000 (0.001)
Oil rents (% of GDP)		-0.004 (0.004)	-0.002 (0.005)
Foreign direct investment, net inflows (% of GDP)		0.000 (0.000)	0.001 (0.002)
US treasury rate		0.016** (0.006)	0.020*** (0.007)
Pegged XR			0.008 (0.026)
High CBI			0.000 (0.030)
Chinn-Ito index			0.000 (0.013)
IMF prog. in place			-0.038 (0.028)
Currency crisis			-0.058** (0.027)
Inflation crisis			-0.169*** (0.049)
Sov. debt crisis			0.171 (0.119)
Democracy (VDem)			0.023 (0.127)
Observations	12,179	11,023	8,163
R-squared	0.070	0.073	0.115
Number of countries	103	87	79

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table 2: This table reports results of OLS regressions of the proportion of domestic currency issuance (by month) on government partisanship (by month, lagged) and varying sets of controls. Country fixed effects are suppressed, as is a cubic polynomial in time.

independence (Hypothesis 2).<sup>45</sup> We do indeed find that left governments in developing countries with high CBI are significantly more likely to issue debt in domestic currency. Results conditional on a pegged exchange rate are similar: left governments issue a greater proportion of domestic-denominated bonds under a pegged exchange rate (Hypothesis 3). These findings are consistent with our argument that left governments take advantage of credibility-enhancing institutions that improve their ability to make choices in line with their ideological preferences.

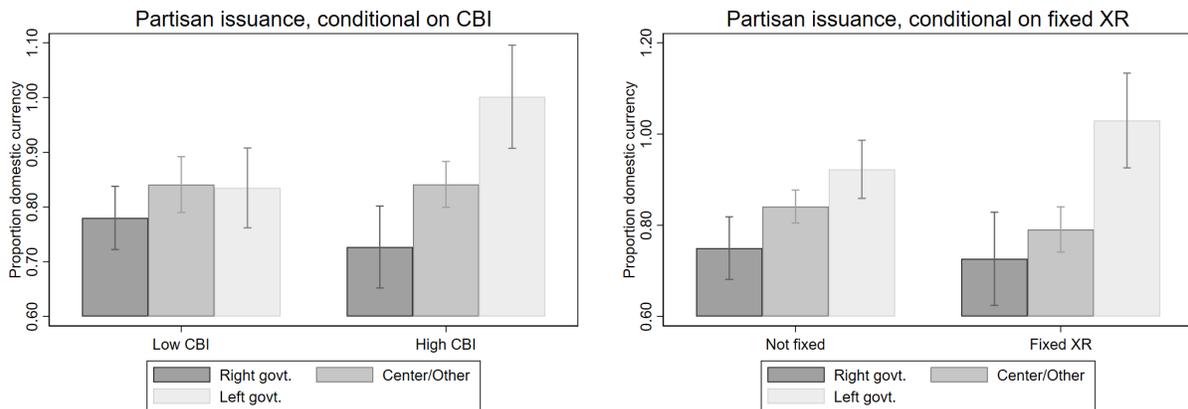


Figure 4: Effect of government partisanship on proportion domestic currency debt issued, depending on institutional constraints. The left panel conditions on a dichotomous measure of central bank independence, while the right panel conditions on a dummy for fixed exchange rates. 95% confidence intervals reported.

Above, we have argued that—as right governments’ preferences for foreign currency denomination largely square with the preferences of investors—it is not clear theoretically whether we should expect similar partisan differences from right governments with strong institutional protections for the value of the domestic currency. As reported in Figure 4, in the presence of strong central bank independence, right governments appear even more likely to choose foreign over domestic denomination; this suggests that the right’s ideological commitment to forego domestic denomination complements the ideological commitment to CBI. Additionally, when the exchange rate is fixed, the point estimate suggests that right governments are even less likely to denominate in domestic currency, although this difference is not statistically significant at conventional levels. This would be consistent with the right’s ideological preference to “bind the hands” of successor governments, expressed both via denomination choice and a fixed exchange rate.

<sup>45</sup>Full regression results for this and subsequent figures are reported in Appendix Table A.2.

Yet, left governments' credibility may be undermined by ongoing macroeconomic instability; the presence of crises affecting the value of the currency can therefore undermine a left government's ability to come to terms that include domestic denomination (Hypothesis 4). First, we expect that cases of rampant inflation, as a particularly relevant kind of economic mismanagement likely to drive subsequent devaluation, will suggest to investors increased currency risk. Figure 5 reports the results of an interaction of government partisanship with ongoing inflation crisis. We find that left governments not currently facing crisis remain capable of issuing a significantly greater percentage of domestic-denominated bonds (than centrist/other or right governments); interestingly, in countries facing runaway inflation left governments' denomination outcomes appear indistinguishable from their centrist/other counterparts.

Second, we expect that a crashing exchange rate during a currency crisis makes investors especially reluctant to buy or hold domestic-denominated bonds, and that this reluctance particularly affects left governments given their denomination preferences. Figure 5 reports results from an interaction of currency crisis and government partisanship. Consistent with the view that left governments will be unable to issue in domestic currency when the market perceives the risks from such issuance as too high, we find that the positive and significant association between left government and domestic issuance present during "normal" economic times (relative to centrist/other governments) disappears during periods of wild oscillation in exchange rates. Interestingly, as reported in Figure 5, periods of macroeconomic disequilibrium appear to affect right governments' decisions over currency issuance as well. In particular, it appears that right governments' preference for foreign currency issuance is primarily pronounced when facing monetary crises; in "normal" times, however, right governments are indistinguishable from centrists in their currency issuance.<sup>46</sup> While we leave further refinement of this finding to future research, we note that this behavior is consistent with efforts by right governments to enforce monetary discipline through the taking on of additional foreign-currency debts.

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<sup>46</sup>Note that, whatever the crisis conditions, right governments issue lower percentages of domestic-denominated bonds than left governments as predicted by Hypothesis 1.

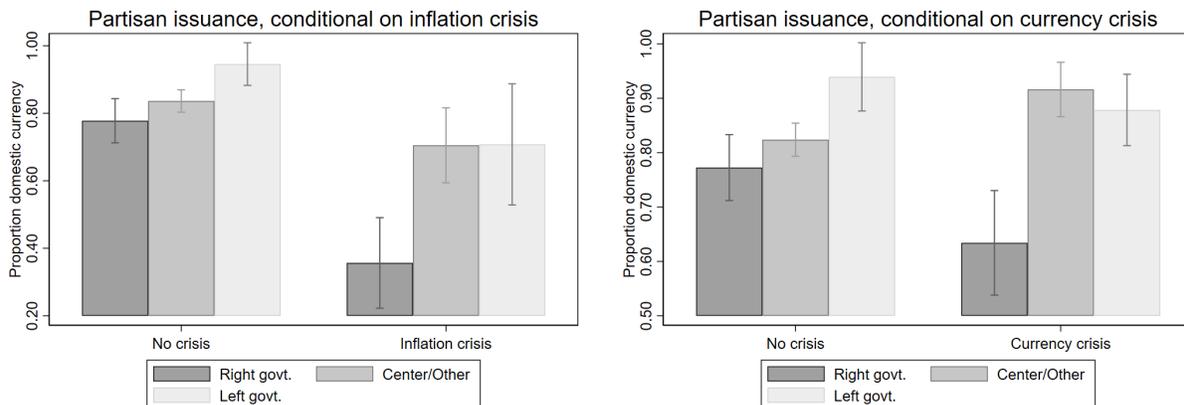


Figure 5: Effect of government partisanship on proportion domestic currency debt issued, depending on crisis environment. The left panel conditions on a measure of whether the country is facing an inflation crisis, while the right panel conditions on a contemporaneous currency crisis. 95% confidence intervals reported.

### 5.3 Robustness and Extensions

Here, we focus on four key robustness and extension analyses: confirming effects over time; investigating our effects across regime type; employing an alternative coding for partisanship; and incorporating institutional correlates of left government.<sup>47</sup>

#### 5.3.1 Effects over time

First, we directly confront the question of whether denomination decisions were once politically relevant but are not anymore, given the boom in domestic issuance (see again Figure 1). Recall that our specifications include cubic polynomials in time to account for common secular evolution of dynamics across the entire sample. Still, is the effect of government ideology that we recover simply an artefact of a particular time period?

We re-estimate our core specification with dummies for the 1990s and 2000s (with the 2010s as the excluded category), and interact each decade dummy with our government partisanship measures. The results support our contention that the systematic relationship between left governments and domestic denomination is consistent and not an artefact of time,<sup>48</sup> with Figure 6 summarizing the key findings. First, both right and left governments issue greater proportions of

<sup>47</sup>In the Online Appendix, we provide additional evidence of the robustness of our results by aggregating all data to country-year; including short-term (<1 year) issues; and addressing selection considerations.

<sup>48</sup>That is, the interaction terms are not significant or substantively meaningful. See Appendix Table A.7 for full regression results.

domestic-denominated debt as time goes on. This trend is consistent with the reality that, given that the boom in domestic denomination is indicative of lower costs of bond terms that include that choice, right ideology does not necessitate right governments looking a “gift horse in the mouth.”<sup>49</sup> Nonetheless, variation in partisan outcomes remains apparent: right governments issue lower proportions of domestic-denominated debt than left governments in the 1990s, 2000s, and 2010s (data through 2016). This is consistent with our theoretical argument that implies that partisan preferences are enduring and thus should be relevant whatever the overall market conditions. Additionally, center/other governments do not exhibit as clear of a trend in issuance, consistent with our theory that these governments as a category do not have enduring, clear preferences over denomination. Empirically, their issuance in domestic currency increases from the 1990s to the 2000s; by the 2010s their outcomes are indistinguishable from those of right governments, and point estimates are consistently lower than left governments.

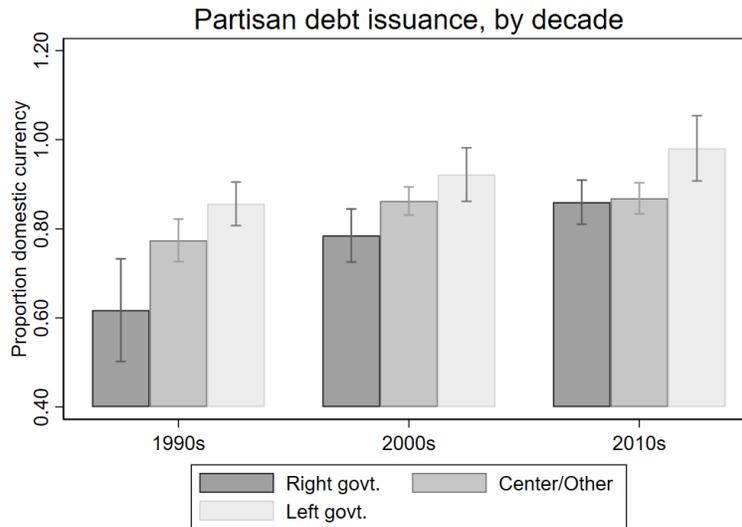


Figure 6: Estimated proportion of domestic-currency denominated sovereign bonds (in non-OECD countries), averaged by government partisanship and decade. 95% confidence intervals reported.

<sup>49</sup>While our primary measure of partisanship does vary monthly, one might worry that—as our other primary conditioning variables only exhibit annual variation—the use of country-month as our unit of analysis might be inappropriate. We therefore replicate all our core findings at the country-year level in Appendix A.4. While clearly we experience a substantial loss in statistical power when reduced to country-year, our qualitative findings are reconfirmed using this more coarse unit of analysis.

### 5.3.2 Subset on regime type

Thus far, we have controlled for the possibility of a direct effect of democracy on currency composition in a sample of all non-OECD countries for which the DPI provides data on partisanship (Cruz, Keefer and Scartascini, 2018). However, our arguments are premised on the existence of political contestation: we expect governments’ domestic incentives to reflect their ideological leanings, which are ultimately linked to electoral concerns. While all sovereigns that maintain their own currencies confront the issue of how to denominate their bond issues, face-value partisanship may thus be a less meaningful predictor of a non-democratic regime’s choice over terms. To explore this potential heterogeneity, we split our data based on a binary measure of democracy (Magaloni and Min, 2013). Among the subsample of democracies, the effects of left and right governments are robust (column 1 of Appendix Table A.5). In contrast, in the subset of non-democracies, left and right partisanship are signed as expected but both lose statistical significance. These results underscore the importance of research questioning how the politics of sovereign debt in non-democracies does or does not reflect that in democracies (Ballard-Rosa, 2016, 2020).

### 5.3.3 Alternative coding for government partisanship

While we have so far used a standard source of information on government partisanship by relying on data from the DPI, it is possible that in seeking to fit government economic ideology into discrete categories the DPI coding may suffer from some mischaracterizations. Of course, so long as these miscodings of government partisanship are not systematically associated with the currency composition of government bonds, this measurement error will primarily serve to attenuate any true effect. Indeed, it is difficult to come up with a reason why such partisan codings would be likely to lead to directional bias in our primary estimates regarding proportions of domestic currency denomination.

However, to further probe the robustness of our main results, we employed new data from the VDem project provided in the VParty Dataset. These data relies on aggregated measures of expert codings to identify party characteristics for most political parties in the world from 1970-2019 (Luhrmann and coauthors, 2020; Pemstein and coauthors, 2020). In particular, to match our theoretical interest in partisan preferences over monetary policy, we draw upon VParty’s coding of parties along an “economic left-right scale.” As described in the codebook, left parties “want

government to play an active role in the economy. This includes higher taxes, more regulation and government spending and a more generous welfare state.” Alternately, right parties “emphasize a reduced economic role for government: privatization, lower taxes, less regulation, less government spending, and a leaner welfare state.” A group of country experts are asked to place parties on a possible 7-point scale ranging from “far left” to “far right,” and these estimates are then averaged according to a Bayesian updating process and centered around zero.

As demonstrated in Appendix A.3, when we replace our primary categorical measure of government partisanship from the DPI with this continuous measure of government right-left ideology from VParty, we continue to find that left-leaning governments are significantly more likely to issue debt in domestic currency.<sup>50</sup> In addition, we continue to find evidence for the role of institutional constraints in shaping the market’s tolerance for issuance of domestic-currency bonds to left governments, as we find that the effect of a marginal increase towards the left side of the political spectrum is only significantly associated with expanded domestic issuance in the presence of central bank independence and fixed exchange rates. Similarly, we find that while left governments outside of crisis environments are significantly more likely to issue in their own currency, this effect disappears in the presence of ongoing inflation or currency crises likely to scare investors away from these domestic currencies. Thus, even when employing a conceptually distinct measure of government ideology from a completely different data source, we continue to find strong evidence that partisan preferences shape bond terms, particularly when markets are willing to tolerate them.

### **5.3.4 Institutional correlates of left government**

An alternative source of concern with our results might arise if there are additional institutional correlates of partisan governments that might also affect preferences over currency denomination of sovereign debt. One potential institutional factor might be the type of electoral institution in place in a given country; that is, the impact of government partisanship could vary across majoritarian as opposed to proportional representation systems.<sup>51</sup> As reported in Appendix Table A.6, while governments in PR systems do appear somewhat less likely to issue domestic-denominated debt,

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<sup>50</sup>To be precise, we regress the proportion of bonds issued in domestic currency on the left-right ideology of the party that won the largest vote share in the prior election, as well as our full set of controls described above. As in all our results, we code government partisanship in the month-year that the new government takes office as opposed to the month-year of the election.

<sup>51</sup>We thank an anonymous reviewer for this suggestion, as well as for the following two suggestions reported below.

the inclusion of a control for electoral institutional type does not change the substantive size or statistical significance of our core findings of interest on government partisanship.

Alternately, when considering the conditioning effects of institutions to constrain monetary policy, while we have accounted for current institutional conditions, one might worry that left and right governments might have underlying preferences for differing monetary regimes, and that the length of time since such institutions have been in place might matter for investor expectations about their durability. We address this concern in Appendix Table A.6 by including measures of the length of time (in years) that a given country had high levels of CBI (in column 2) or a fixed exchange rate (in column 4). Note that these direct controls for the length of time under a given institution do not attenuate our main partisan effects of interest. We additionally probe this effect by interacting our measure of government partisanship with the time with high CBI (in column 3) or with a fixed exchange rate (in column 5). As reported in column 3, we do recover (weakly) statistically significant results suggesting that the capacity of left governments to issue more debt in domestic currency is strengthened the longer that central bank independence has been in place; this finding is consistent with a view of the left’s ability to issue in domestic currency being constrained by market expectations over potential monetary “malfeasance.” However, in column 5 we fail to find any evidence that the length of time since a fixed exchange rate has been in place has any conditioning influence on our main findings that left governments issue significantly more, and right governments significantly less, domestic denominated debt.<sup>52</sup>

## 6 Conclusion

For developing countries, the expansion of international capital markets in general, and sovereign bond markets specifically, offers opportunities as well as threats. Governments have been increasingly able to borrow to fund their activities, but in doing so they may expose themselves to pressures to enact or avoid certain policies. As such, financial openness could reduce the ability of governments to achieve their traditional ideological goals and, in turn, to serve their core constituents. The “original sin” logic offers one version of market-based constraints, in that developing coun-

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<sup>52</sup>In unreported additional specifications, we have also attempted to evaluate whether the “stability” of the exchange rate mattered (as a function of annual variance in the real dollar exchange rate), but did not recover any significant results.

tries were assumed to be unable to find an international market for domestic-denominated bonds (Eichengreen and Hausmann, 2005). Its logic implies that, in seeking credit, developing country governments have little-to-no agency over the terms at which they borrow. Instead, supply side considerations – investors’ preferences – loom very large.

The boom in the proportion of sovereign bonds issued in domestic currency, revealed by our data, undermines this expectation. Nonetheless, the new market appetite for domestic-denominated sovereign debt does not erase the importance of domestic politics to borrowing outcomes. Left governments prefer domestic denomination, thereby preserving the possibility of future monetary policy flexibility and insulation from depreciation-induced increases in debt repayment costs. Right governments, by contrast, have an ideological predisposition toward foreign currency denomination, welcoming the lower costs and macroeconomic constraints it brings. Our analyses offer evidence that left governments in developing countries often are able to achieve their demand-side preferences: they are significantly more likely to issue debt denominated in their own currencies. Right governments, on the other hand, have followed the more general market shift toward domestic currency borrowing, despite their underlying ideological predispositions.

Still, vestiges of the “original sin” dynamic remain: issuing domestic-denominated sovereign bonds on international markets requires compensation. In our data, we uncover a systematic correlation between domestic denomination and compensation in the form of shorter maturities. Future scholarship would do well to pay more attention to how debt management offices (DMOs) conceive of the tradeoffs across bond terms, as well as how they attempt to market their debt to varying groups of investors. Indeed, variation in the investor base is likely to generate variation in the constraints faced by debtor governments (Schlegl, Trebesch and Wright, 2019; Tomz and Wright, 2013). And, more broadly, political economists have paid much less attention to the origins and role of DMOs, especially relative to central banks.<sup>53</sup>

Additionally, while left governments find it more difficult to choose domestic denomination when crisis heightens currency risks, they are better able to come to terms including domestic denomination when constrained by an independent central bank or pegged exchange rate. Hence, supply-side concerns with currency risk are ameliorated as a result of governments’ other institutional features and choices. This conditioning effect of national economic institutions points

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<sup>53</sup>But see Missale (2000); Sadeh and Porath (2019).

to a need for greater attention to governments' choices not only across financing terms and debt instruments (Arias, Mosley and Rosendorff, N.d.; Bunte, 2019), but also across national economic institutions. Governments reforming their institutions often are making tradeoffs across types of constraints. In the area of sovereign debt, this is especially relevant as international financial institutions encourage developing country governments to make their debt management offices (DMOs) not only more professionalized but also more insulated from political authority (Blommestein and Horman, 2007; Missale, 2000; Sadeh and Rubinson, 2018).

Finally, our data reveal massive changes in the marketplace for assets involving domestic currencies, which speak to the debate over whether economic globalization leads toward convergence on a small number of global reserve currencies. Such convergence would privilege countries whose currencies sit atop the global pyramid while reducing the power of others (Cohen, 2015), and it would weaken other countries' access to the state-building benefits that come with national currencies (Helleiner, 2003; McDowell, 2020). Consistent with the "currency as power" narrative, the dollar and the euro are key currencies for many international transactions, issuers of global reserve currencies experience a variety of benefits, and governments such as China seek to increase the international use of their currencies (Broz, Zhang and Wang, 2018; Liao and McDowell, 2016). Nonetheless, it is clear from our data that a great number of currencies now feature in global sovereign debt markets. Private investors in these markets seem to have appetites for portfolios including developing country currencies—and to have been able to come to terms including sufficient compensation to whet those appetites. For the 131 sovereign issuers covered in our data (1990-2016), national currencies remain very much alive.

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# A Appendix

## A.1 Data sources

VARIABLE NAME	SOURCE
Bond issues: timing, amount, and terms (currency, maturity, and yield)	Bloomberg terminals (see replication data)
Government partisanship	World Bank, Database of Political Institutions (DPI)
GDP per capita	World Bank, World Development Indicators (WDI)
GDP growth	World Bank, World Development Indicators (WDI)
External debt	Abbas et al. (2010)
Current account balance	World Bank, World Development Indicators (WDI)
Trade	World Bank, World Development Indicators (WDI)
Oil rents	World Bank, World Development Indicators (WDI)
Foreign direct investment, net inflows	World Bank, World Development Indicators (WDI)
Interest rate on 10-year US Treasury bonds	US Federal Reserve
Pegged exchange rate	Shambaugh (2004)
Central bank independence	Weighted measure from Garriga (2016)
Capital account openness	Chinn and Ito (2006)
IMF program in place	Dreher (2006)
Inflation crisis	Valencia and Laeven (2012)
Inflation crisis history	Calculated from Valencia and Laeven (2012)
Sovereign debt crisis	Valencia and Laeven (2012)
Currency crisis	Valencia and Laeven (2012)
Democracy	“Polyarchy” score from Varieties of Democracy (VDem)

Table A.1: Variable definitions and sources.

## A.2 Full regression output from text

Domestic currency bond issuance (1990-2016), Non-OECD countries

VARIABLES	(1) CBI	(2) Peg XR	(3) Currency crisis	(4) Inflation crisis
Right govt.	-0.061 (0.040)	-0.096** (0.037)	-0.029 (0.031)	-0.049 (0.033)
Left govt.	0.001 (0.051)	0.076* (0.041)	0.128*** (0.042)	0.111** (0.044)
High CBI	0.002 (0.039)	0.000 (0.027)	0.009 (0.032)	-0.014 (0.026)
Right govt. x CBI	-0.055 (0.052)			
Left govt. x CBI	0.142** (0.069)			
Pegged XR	0.003 (0.026)	-0.042 (0.027)	0.002 (0.028)	0.002 (0.027)
Right govt. x Peg		0.054 (0.051)		
Left govt. x Peg		0.168*** (0.050)		
Currency crisis		-0.064** (0.027)	0.072*** (0.024)	
Right govt. x Currency crisis			-0.269*** (0.074)	
Left govt. x Currency crisis			-0.151*** (0.048)	
Inflation crisis	-0.204*** (0.048)	-0.189*** (0.044)		-0.133** (0.060)
Right govt. x Inflation crisis				-0.281*** (0.105)
Left govt. x Inflation crisis				-0.116 (0.084)
Baseline controls	✓	✓	✓	✓
Full controls	✓	✓	✓	✓
Observations	8,178	8,163	8,163	8,163
R-squared	0.111	0.112	0.109	0.121
Number of countries	79	79	79	79

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

Table A.2: This table reports results of OLS regressions of proportion of domestic-currency denominated bonds on government partisanship interacted with measures for economic institutions and crisis environments, along with a full set of controls. Country and year fixed effects are suppressed, as is a cubic polynomial in time.

Amount issued (% GDP) (1990-2016)

VARIABLES	(1) Amount issued
Right govt.	0.052 (0.101)
Left govt.	-0.121 (0.079)
GDP per capita	-0.017 (0.065)
GDP growth (annual %)	-0.010* (0.006)
External debt (% of GDP)	0.002 (0.001)
Current account balance (% of GDP)	-0.004* (0.002)
Trade (% of GDP)	-0.003 (0.003)
Oil rents (% of GDP)	0.006 (0.004)
FDI, net inflows (% of GDP)	-0.002 (0.002)
US treasury rate	-0.045* (0.026)
Pegged XR	0.031 (0.027)
High CBI	-0.008 (0.082)
Chinn-Ito index	0.013 (0.019)
IMF prog. in place	0.017 (0.077)
Currency crisis	-0.019 (0.036)
Inflation crisis	-0.047 (0.045)
Sov. debt crisis	0.022 (0.102)
Democracy (VDem)	0.294 (0.264)
Observations	17,879
Number of countries	84
R-squared	0.004

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.3: This table reports results of OLS regression of amount of sovereign bonds issued (by month, % GDP) on government partisanship and a full set of controls. Country fixed effects are suppressed, as is a cubic polynomial in time.

Domestic currency bond issuance by decade, Non-OECD countries

VARIABLES	(1) Decade dummies
Right govt.	-0.017 (0.039)
Right govt. x 1990s	-0.132* (0.071)
Right govt. x 2000s	-0.024 (0.035)
Left govt.	0.152*** (0.052)
Left govt. x 1990s	-0.076 (0.056)
Left govt. x 2000s	-0.051 (0.037)
1990s	0.184*** (0.055)
2000s	0.064** (0.026)
GDP per capita	-0.059 (0.049)
GDP growth (annual %)	0.001 (0.002)
External debt (% of GDP)	0.001 (0.001)
Current account balance (% of GDP)	0.003 (0.003)
Trade (% of GDP)	-0.001 (0.001)
Oil rents (% of GDP)	-0.002 (0.006)
Foreign direct investment, net inflows (% of GDP)	0.002 (0.002)
US treasury rate	0.019*** (0.007)
Pegged XR	0.011 (0.026)
High CBI	0.009 (0.028)
Chinn-Ito index	-0.003 (0.013)
IMF prog. in place	-0.038 (0.026)
Currency crisis	-0.058** (0.028)
Inflation crisis	-0.177*** (0.047)
Sov. debt crisis	0.137 (0.115)
Democracy (VDem)	-0.005 (0.123)
Observations	8,163
Number of countries	79
R-squared	0.122

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

Table A.4: This table reports results of OLS regressions of the proportion of domestic-currency denominated bonds on government partisanship interacted with a dummy for decade, along with a full set of controls. Country fixed effects are suppressed, as is a cubic polynomial in time.

Domestic currency bond issuance (1990-2016), Democracies vs Autocracies

VARIABLES	(1) Democ. only	(2) Autoc. only
Right govt.	-0.076** (0.033)	-0.243 (0.158)
Left govt.	0.093** (0.039)	0.150 (0.202)
GDP per capita	-0.059 (0.073)	0.056 (0.055)
GDP growth (annual %)	0.004* (0.003)	-0.003 (0.002)
External debt (% of GDP)	0.001 (0.001)	0.002 (0.002)
Current account balance (% of GDP)	0.004 (0.003)	-0.001 (0.004)
Trade (% of GDP)	-0.000 (0.001)	-0.001 (0.001)
Oil rents (% of GDP)	0.001 (0.009)	0.004 (0.004)
FDI, net inflows (% of GDP)	0.003 (0.003)	-0.001 (0.002)
US treasury rate	0.024*** (0.008)	0.007 (0.015)
Pegged XR	-0.013 (0.041)	0.050* (0.027)
High CBI	0.004 (0.040)	-0.020 (0.037)
Chinn-Ito index	0.000 (0.018)	-0.026 (0.046)
IMF prog. in place	-0.032 (0.031)	-0.116** (0.048)
Currency crisis	-0.053* (0.031)	-0.032 (0.031)
Inflation crisis	-0.197*** (0.059)	0.002 (0.042)
Sov. debt crisis	0.176 (0.114)	-0.254 (0.311)
Democracy (VDem)	0.088 (0.154)	-0.584* (0.299)
Observations	5,992	2,171
R-squared	0.135	0.077
Number of countries	56	39

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.5: This table reports results of OLS regressions taking proportion of bonds issued in domestic currency as the dependent variable, separately for democratic and non-democratic countries. Country fixed effects are suppressed, as is a cubic polynomial in time.

Domestic currency bond issuance, Institutional Controls

VARIABLES	(1) PR	(2) CBI time	(3) CBI time	(4) Peg time	(5) Peg time
Right govt.	-0.072** (0.032)	-0.060* (0.034)	-0.074 (0.046)	-0.073** (0.032)	-0.076** (0.036)
Left govt.	0.109** (0.044)	0.119*** (0.044)	0.043 (0.043)	0.106** (0.041)	0.104** (0.042)
Proportional Representation	-0.141* (0.073)				
Time since CBI		0.009** (0.005)	0.005 (0.005)		
Right X CBI time			0.002 (0.006)		
Left X CBI time			0.012* (0.006)		
Time since peg XR				0.001 (0.007)	0.001 (0.009)
Right X Peg time					0.001 (0.006)
Left X Peg time					0.001 (0.008)
Baseline controls	✓	✓	✓	✓	✓
Full controls	✓	✓	✓	✓	✓
Observations	7,838	7,863	7,863	8,308	8,308
R-squared	0.116	0.124	0.130	0.108	0.108
Number of countries	77	73	73	78	78

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.6: This table reports results of OLS regressions of the proportion of domestic-currency denominated bonds on government partisanship, as well as controls for additional factors potentially correlated with left government. Country fixed effects are suppressed, as is a cubic polynomial in time.

### A.3 Results using VParty partisan coding

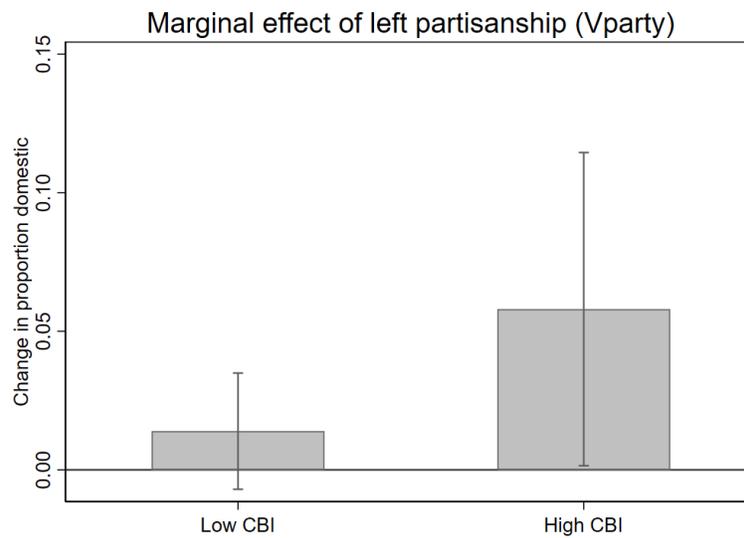


Figure A.1: Government partisanship and currency of issuance, using VParty data.

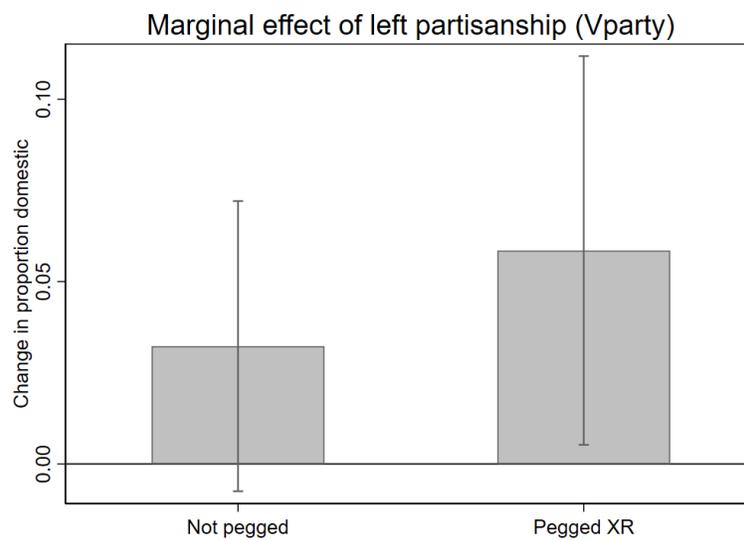


Figure A.2: Government partisanship and currency of issuance, using VParty data.

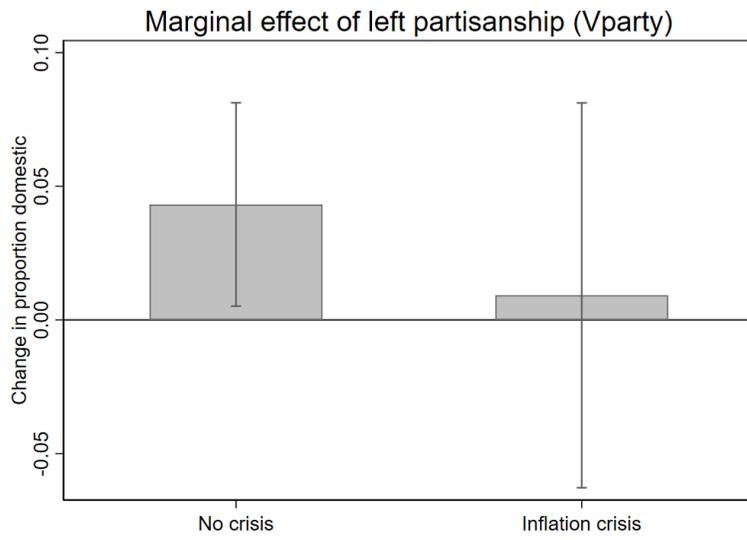


Figure A.3: Government partisanship and currency of issuance, using VParty data.

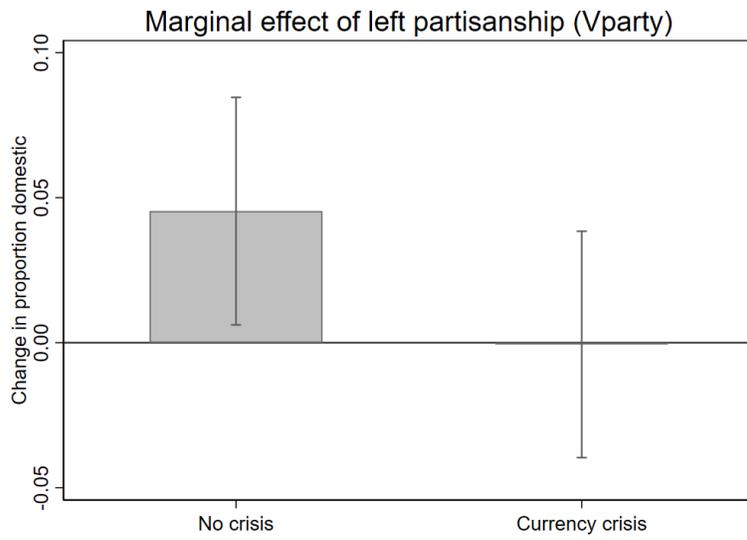


Figure A.4: Government partisanship and currency of issuance, using VParty data.

Domestic currency bond issuance (1990-2016), Non-OECD countries, using VParty data

VARIABLES	(1) % Domestic	(2) % Domestic	(3) % Domestic	(4) % Domestic	(5) % Domestic
Right-left partisanship	0.035* (0.019)	0.014 (0.011)	0.032 (0.020)	0.045** (0.020)	0.043** (0.019)
High CBI		0.041 (0.032)			
CBI x RL partisanship		0.044 (0.027)			
Pegged XR			-0.015 (0.035)		
Peg x RL partisanship			0.026 (0.026)		
Currency crisis				-0.014 (0.026)	
Currency crisis x RL partisanship				-0.046*** (0.017)	
Inflation crisis					-0.186*** (0.053)
Inflation crisis x RL partisanship					-0.034 (0.033)
Baseline controls	✓	✓	✓	✓	✓
Full controls	✓	✓	✓	✓	✓
Observations	7,121	7,121	7,121	7,121	7,121
R-squared	0.095	0.085	0.083	0.085	0.082
Number of countries	71	71	71	71	71

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

Table A.7: This table reports results of OLS regressions of the proportion of domestic-currency denominated bonds on a continuous measure of government economic ideology, along with a full set of controls. Country fixed effects are suppressed, as is a cubic polynomial in time.

#### A.4 Results by country-year

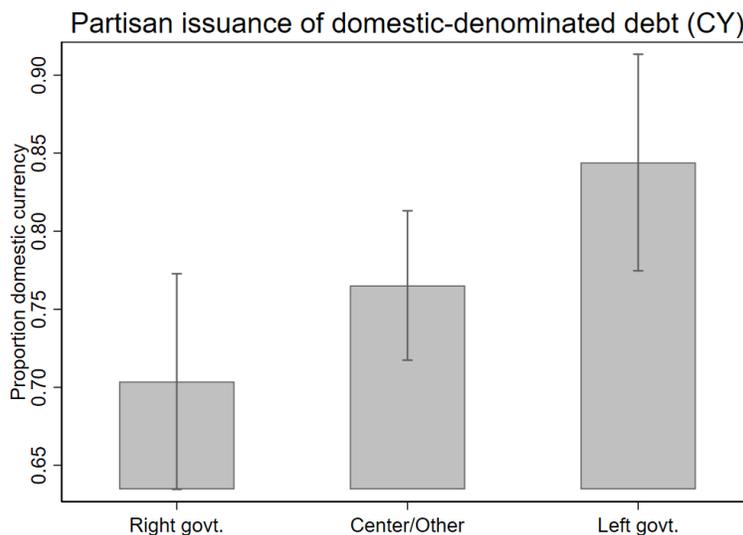


Figure A.5: Government partisanship and currency of issuance, by country-year.

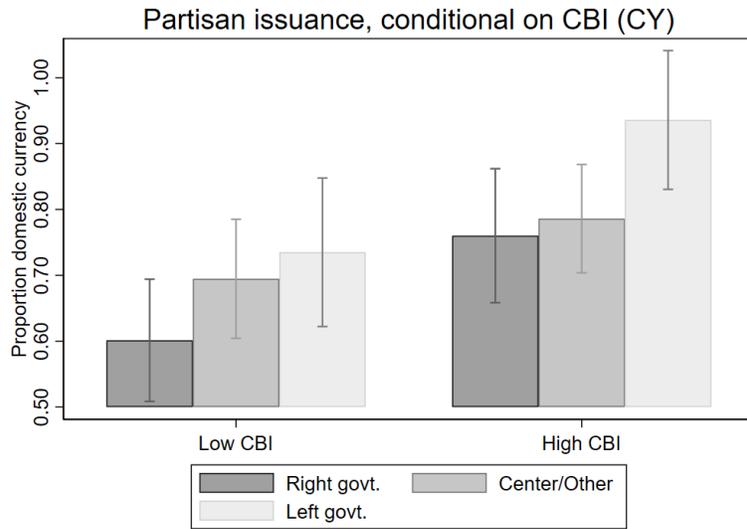


Figure A.6: Government partisanship and currency of issuance, by country-year.

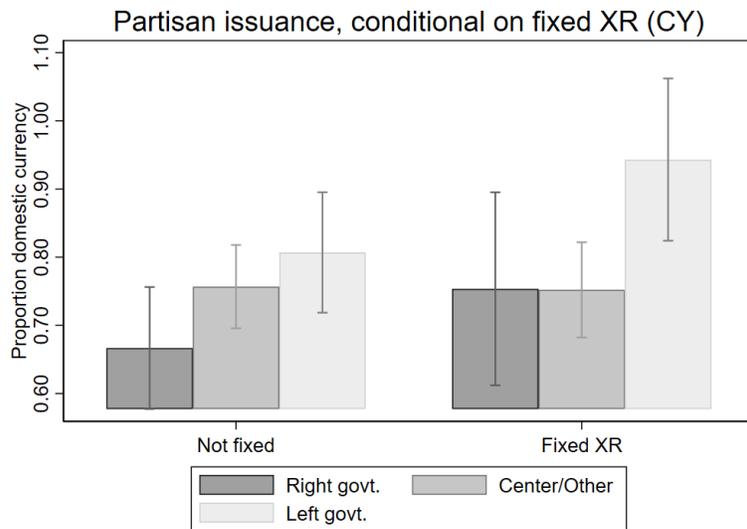


Figure A.7: Government partisanship and currency of issuance, by country-year.

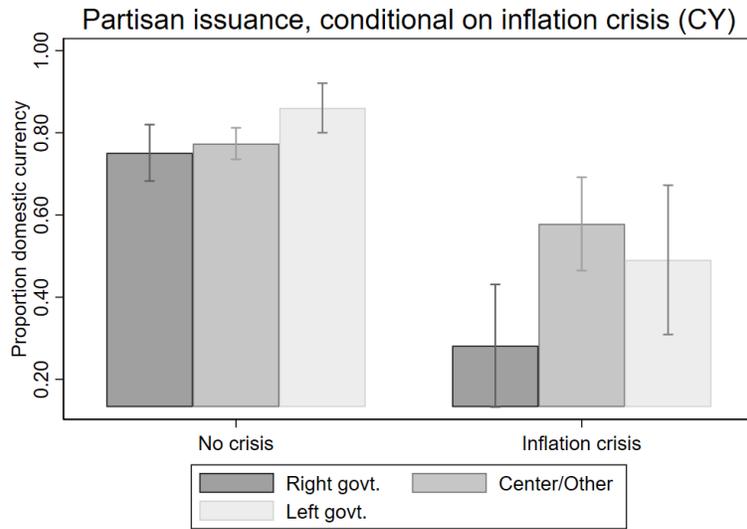


Figure A.8: Government partisanship and currency of issuance, by country-year.

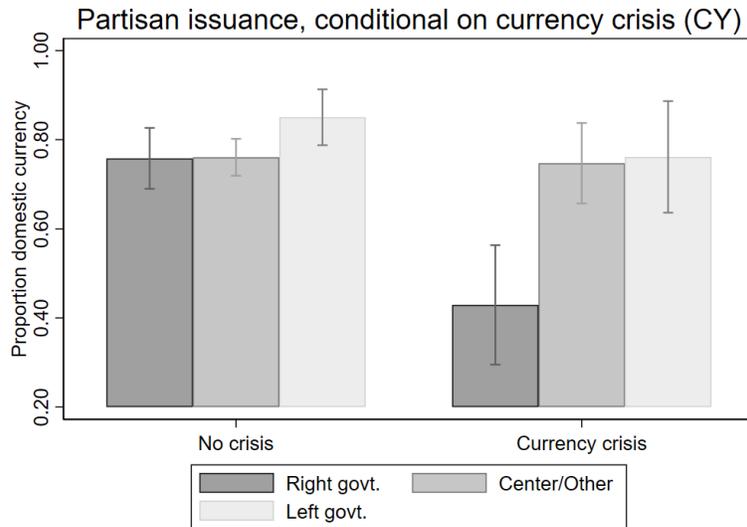


Figure A.9: Government partisanship and currency of issuance, by country-year.

Domestic currency bond issuance (1990-2016), Non-OECD countries, by country-year

VARIABLES	(1) Partisanship	(2) CBI	(3) Peg	(4) Curr. crisis	(5) Infl. crisis
Right	-0.062 (0.053)	-0.093 (0.065)	-0.090 (0.063)	-0.002 (0.047)	-0.022 (0.046)
Left	0.079 (0.055)	0.040 (0.075)	0.050 (0.062)	0.090* (0.049)	0.087* (0.046)
High CBI		0.091 (0.071)			
Right x CBI		0.068 (0.086)			
Left x CBI		0.110 (0.093)			
Pegged XR			-0.005 (0.043)		
Right x Peg			0.092 (0.084)		
Left x Peg			0.141* (0.077)		
Currency crisis				-0.013 (0.048)	
Right x Currency crisis				-0.316*** (0.084)	
Left x Currency crisis				-0.076 (0.075)	
Inflation crisis					-0.195*** (0.061)
Right x Inflation crisis					-0.274** (0.107)
Left x Inflation crisis					-0.174 (0.107)
Baseline controls	✓	✓	✓	✓	✓
Observations	1,384	1,140	1,317	1,384	1,384
R-squared	0.154	0.193	0.162	0.184	0.215
Number of ccode	86	84	85	86	86

Robust standard errors in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.8: This table reports results of OLS regressions of the proportion of domestic-currency denominated bonds (by country-year) on government partisanship interacted with measures for economic institutions and crisis environments, along with a full set of controls. Country fixed effects are suppressed, as is a cubic polynomial in time.

## A.5 Including short-term bond issues

Domestic currency bond issuance (1990-2016), Non-OECD countries, all bonds issued

VARIABLES	(1) Bivar.	(2) Baseline	(3) Full controls
Right govt.	-0.029 (0.027)	-0.017 (0.025)	-0.010 (0.029)
Left govt.	0.061 (0.043)	0.071* (0.038)	0.092** (0.035)
GDP per capita		0.012 (0.048)	0.008 (0.047)
GDP growth (annual %)		0.004*** (0.001)	0.003** (0.002)
External debt (% of GDP)		0.002* (0.001)	0.002*** (0.001)
Current account balance (% of GDP)		-0.000 (0.001)	0.001 (0.002)
Trade (% of GDP)		-0.000 (0.001)	-0.000 (0.001)
Oil rents (% of GDP)		0.000 (0.002)	0.002 (0.003)
Foreign direct investment, net inflows (% of GDP)		-0.000 (0.000)	0.001 (0.001)
US treasury rate		0.011** (0.005)	0.016*** (0.005)
Pegged XR			-0.005 (0.021)
High CBI			-0.010 (0.022)
Chinn-Ito index			0.001 (0.011)
IMF prog. in place			-0.037 (0.025)
Currency crisis			-0.044* (0.026)
Inflation crisis			-0.090** (0.038)
Sov. debt crisis			0.184** (0.090)
Democracy (VDem)			-0.072 (0.098)
Observations	16,141	14,416	10,499
R-squared	0.050	0.061	0.102
Number of countries	104	89	80

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.9: This table reports results of OLS regressions of the proportion of domestic currency issuance (by month, all bonds issued) on government partisanship (by month, lagged) and varying sets of controls. Country effects are suppressed, as is a cubic polynomial in time.

Domestic currency bond issuance (1990-2016), Non-OECD countries, all bonds issued

VARIABLES	(1) CBI	(2) Fix XR	(3) Currency crisis	(4) Inflation crisis
Right govt.	-0.002 (0.037)	-0.017 (0.035)	0.013 (0.029)	0.000 (0.029)
Left govt.	0.027 (0.051)	0.071* (0.036)	0.095*** (0.035)	0.095*** (0.036)
High CBI	-0.067 (0.048)			
Right govt. x High CBI	-0.031 (0.041)			
Left govt. x High CBI	0.087 (0.068)			
Pegged XR		-0.029 (0.022)		
Right govt. x Peg XR		0.018 (0.049)		
Left govt. x Peg XR		0.103** (0.049)		
Currency crisis			0.047** (0.020)	
Right govt. x Currency crisis			-0.172*** (0.054)	
Left govt. x Currency crisis			-0.072** (0.034)	
Inflation crisis				-0.061 (0.046)
Right govt. x Inflation crisis				-0.117 (0.122)
Left govt. x Inflation crisis				-0.092 (0.060)
GDP per capita	0.029 (0.018)	0.009 (0.049)	0.004 (0.047)	-0.000 (0.046)
GDP growth (annual %)	0.004** (0.002)	0.004** (0.002)	0.003* (0.002)	0.003** (0.002)
External debt (% of GDP)	0.002*** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)
Current account balance (% of GDP)	0.002 (0.002)	0.001 (0.002)	0.001 (0.002)	0.001 (0.002)
Trade (% of GDP)	0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)
Oil rents (% of GDP)	0.002 (0.003)	0.001 (0.003)	0.002 (0.003)	0.002 (0.003)
Foreign direct investment, net inflows (% of GDP)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
US treasury rate	-0.007 (0.007)	0.015*** (0.005)	0.016*** (0.005)	0.017*** (0.005)
Pegged XR	-0.008 (0.021)	-0.002 (0.015)	-0.005 (0.022)	-0.006 (0.022)
High CBI	0.050 (0.038)	-0.014 (0.022)	-0.018 (0.022)	-0.019 (0.024)
Chinn-Ito index	0.004 (0.011)	-0.002 (0.011)	-0.001 (0.011)	-0.002 (0.011)
IMF prog. in place	-0.040 (0.025)	-0.041 (0.024)	-0.042 (0.025)	-0.044* (0.026)
Currency crisis	-0.042* (0.024)	-0.044* (0.025)	-0.029 (0.024)	-0.031 (0.026)
Inflation crisis	-0.118*** (0.037)	-0.096** (0.037)	-0.080** (0.032)	-0.034 (0.028)
Sov. debt crisis	0.182** (0.091)	0.182** (0.088)	0.175* (0.095)	0.179* (0.094)
Democracy (VDem)	0.002 (0.110)	-0.082 (0.097)	-0.055 (0.095)	-0.066 (0.098)
Observations	10,499	10,499	10,499	10,499
R-squared	0.095	0.106	0.108	0.109
Number of countries	80	80	80	80

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

Table A.10: This table reports results of OLS regressions of the proportion of domestic-currency denominated bonds (for all bonds issued) on government partisanship interacted with measures for economic institutions and crisis environments, along with a full set of controls. Country fixed effects are suppressed, as is a cubic polynomial in time.

## A.6 Heckman selection estimates

We have demonstrated robust evidence for an association between left government partisanship and domestic currency issuance, as well as the inverse for right governments. However, we can only observe the terms of bonds for those country-months in which issuance actually occurred. This raises the possibility, of course, that our inferences on the effects of partisanship on denomination choice are colored by problems of selection bias, such as might arise if a state’s capacity to borrow internationally at all in a given month is, in part, due to the partisan orientation of its government.

In order to address this potential problem, we re-implement our estimations in a two stage Heckman selection framework. In the first stage, we estimate the probability that a country issues any sovereign bonds in a given month; in the second stage, we account for any potential effects of selection into issuance and re-estimate both the unconditional relationship between government partisanship and currency composition, in addition to the conditional effects of partisanship after accounting for institutional constraints and crisis environments.

In order for Heckman selection models to be consistent, it is standard to identify some factor that helps explain the selection stage but is uncorrelated with the error term in the outcome equation. In our case, this requires a factor that correlates with the issuance of sovereign bonds, but not with the currency composition of the bonds. Here, we rely on democracy and US Treasury rates, drawing on recent work by Ballard-Rosa, Mosley and Wellhausen (2019) that demonstrates a strong effect of democratic regime type on the likelihood of issuance across countries, conditional on global liquidity as measured by US Treasury rates, and recovers no effect of partisanship on the timing or amount of issuance. As reported in column 1 in Appendix Table A.11, we find no evidence that the interaction of democracy and US Treasury rates is related to the currency composition of the debt incurred. While impossible to prove definitively that the “exclusion restriction” for this instrument is valid, we take this as evidence in favor of using the interaction of democracy and US Treasury rates as the excluded factor in our Heckman selection estimations.

Table A.12 reports results from our two-stage Heckman selection estimation. In the issuance stage, we reconfirm results from Ballard-Rosa, Mosley and Wellhausen (2019) that there exists a significant effect of democratic regime type on bond issuance conditioned by global liquidity. Turning then to results from the outcome stage, even after taking into account the possibility of selection bias into our data, we continue to recover a significant unconditional positive association

between left governments and the percent of domestic denomination, as reported in column 1 (Hypothesis 1).<sup>1</sup> Columns 2 through 5 further demonstrate conditional effects of government partisanship consistent with Hypotheses 2 through 4.

In discussion of Heckman models, it is common to report the estimated correlation between the error terms in the selection versus outcome equations. This parameter, generally referred to as  $\rho$ , is reported at the bottom of Table A.12. As can be seen, the estimated correlation between error terms across the two equations is extremely low; in none of the specifications does it come remotely close to rejecting the null hypothesis that the true degree of correlation across these errors is zero, which is usually taken as evidence for the need to perform a correction for sample selection. Thus, while we include Heckman selection results here in order to forestall plausible concerns over selection bias, the data suggest that our original OLS estimates are unlikely to suffer heavily from such bias.

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<sup>1</sup>Note, however, that the negative association between right governments and domestic issuance is less robust in the Heckman selection framework.

Domestic currency issuance and global liquidity (Non-OECD countries, 1990-2016)

VARIABLES	(1) % Domestic
Democracy (VDem)	0.291 (0.246)
Democ. x UST	-0.050 (0.044)
US treasury rate	0.026 (0.029)
GDP per capita	-0.105 (0.067)
GDP growth (annual %)	0.003 (0.002)
External debt (% of GDP)	0.001 (0.001)
Current account balance (% of GDP)	0.002 (0.003)
Trade (% of GDP)	-0.001 (0.001)
Oil rents (% of GDP)	-0.001 (0.007)
FDI, net inflows (% of GDP)	0.002 (0.002)
Pegged XR	0.002 (0.027)
CBI Garriga (weighted)	0.011 (0.081)
Chinn-Ito index	-0.012 (0.016)
IMF prog. in place	-0.044 (0.029)
Inflation crisis	-0.215*** (0.050)
Sov. debt crisis	0.179 (0.126)
Observations	8,187
R-squared	0.099
Number of countries	79

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.11: This table reports results of OLS regressions of the proportion of sovereign bonds issued in domestic currency on an interaction between democracy and US Treasury rates, as well as a set of control variables reported. Country and year fixed effects are suppressed, as is a cubic polynomial in time.

## Domestic currency bond issuance, Heckman selection results

EQUATION	VARIABLES	(1) Baseline	(2) CBI	(3) Peg XR	(4) Currency crisis	(5) Inflation history	
DOMESTIC DENOM. DEBT	Right exec.	-0.069 (0.044)	-0.058 (0.061)	-0.102* (0.052)	-0.021 (0.040)	-0.051 (0.042)	
	Left exec.	0.143** (0.057)	0.039 (0.070)	0.106** (0.054)	0.154*** (0.052)	0.136** (0.054)	
	CBI		0.010 (0.063)				
	Right x CBI		-0.023 (0.071)				
	Left x CBI		0.178* (0.097)				
	Pegged XR				-0.020 (0.039)		
	Right x Peg				0.117 (0.074)		
	Left x Peg				0.164** (0.070)		
	Currency crisis					0.055 (0.050)	
	Right x Currency crisis					-0.282*** (0.078)	
	Left x Currency crisis					-0.130* (0.070)	
	Inflation history						-0.113** (0.053)
	Right x Inflation history						-0.222** (0.102)
	Left x Inflation history						-0.035 (0.093)
	GDP per capita		-0.069 (0.070)	-0.051 (0.063)	-0.071 (0.073)	-0.073 (0.067)	-0.097 (0.070)
	GDP growth (annual %)		-0.001 (0.003)	0.001 (0.003)	-0.000 (0.003)	-0.001 (0.003)	-0.000 (0.003)
	Current account balance (% of GDP)		0.001 (0.003)	0.002 (0.003)	0.001 (0.003)	0.002 (0.003)	0.003 (0.003)
	Trade (% of GDP)		-0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)
	Oil rents (% of GDP)		-0.002 (0.005)	0.002 (0.005)	-0.001 (0.004)	-0.002 (0.005)	-0.003 (0.005)
	FDI, net inflows (% of GDP)		0.001 (0.001)	0.000 (0.002)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
	Public debt (% GDP)		0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
	US Treasury rate		-0.005 (0.010)	-0.003 (0.010)	-0.006 (0.010)	-0.005 (0.010)	-0.004 (0.010)
	ISSUANCE	Democracy	-0.366 (1.085)	-0.241 (1.093)	-0.364 (1.082)	-0.363 (1.083)	-0.362 (1.083)
		US Treasury rate	-0.188* (0.098)	-0.134 (0.100)	-0.188* (0.098)	-0.188* (0.098)	-0.188* (0.098)
		Democ. x UST	0.268* (0.146)	0.250* (0.151)	0.267* (0.145)	0.267* (0.145)	0.267* (0.145)
		Right exec.	-0.063 (0.184)	-0.048 (0.183)	-0.063 (0.184)	-0.063 (0.184)	-0.063 (0.184)
		Left exec.	-0.137 (0.183)	-0.105 (0.181)	-0.137 (0.183)	-0.137 (0.183)	-0.137 (0.183)
GDP per capita		0.383*** (0.128)	0.394*** (0.126)	0.383*** (0.128)	0.383*** (0.128)	0.383*** (0.128)	
GDP growth (annual %)		-0.000 (0.008)	0.001 (0.009)	-0.000 (0.008)	-0.000 (0.008)	-0.000 (0.008)	
Current account balance (% of GDP)		0.014* (0.008)	0.016* (0.009)	0.014* (0.008)	0.014* (0.008)	0.014* (0.008)	
Trade (% of GDP)		-0.003 (0.003)	-0.004 (0.003)	-0.003 (0.003)	-0.003 (0.003)	-0.003 (0.003)	
Oil rents (% of GDP)		-0.012 (0.015)	-0.021 (0.017)	-0.012 (0.015)	-0.012 (0.015)	-0.012 (0.015)	
FDI, net inflows (% of GDP)		0.001 (0.003)	0.003 (0.004)	0.001 (0.003)	0.001 (0.003)	0.001 (0.003)	
Public debt (% GDP)		-0.002 (0.002)	-0.002 (0.002)	-0.002 (0.002)	-0.002 (0.002)	-0.002 (0.002)	
$\rho$		0.019 (0.066)	0.007 (0.056)	0.021 (0.062)	0.011 (0.059)	0.007 (0.058)	
Observations		19,583	19,138	19,583	19,583	19,583	
Number of countries		87	87	87	87	87	

Robust standard errors clustered by country in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table A.12: This table reports results of two-stage Heckman selection estimation, with issuance of debt as the selection outcome and proportion of foreign-currency denominated bonds as the second state outcome. Country and calendar month fixed effects are suppressed.

## A.7 Descriptive figures

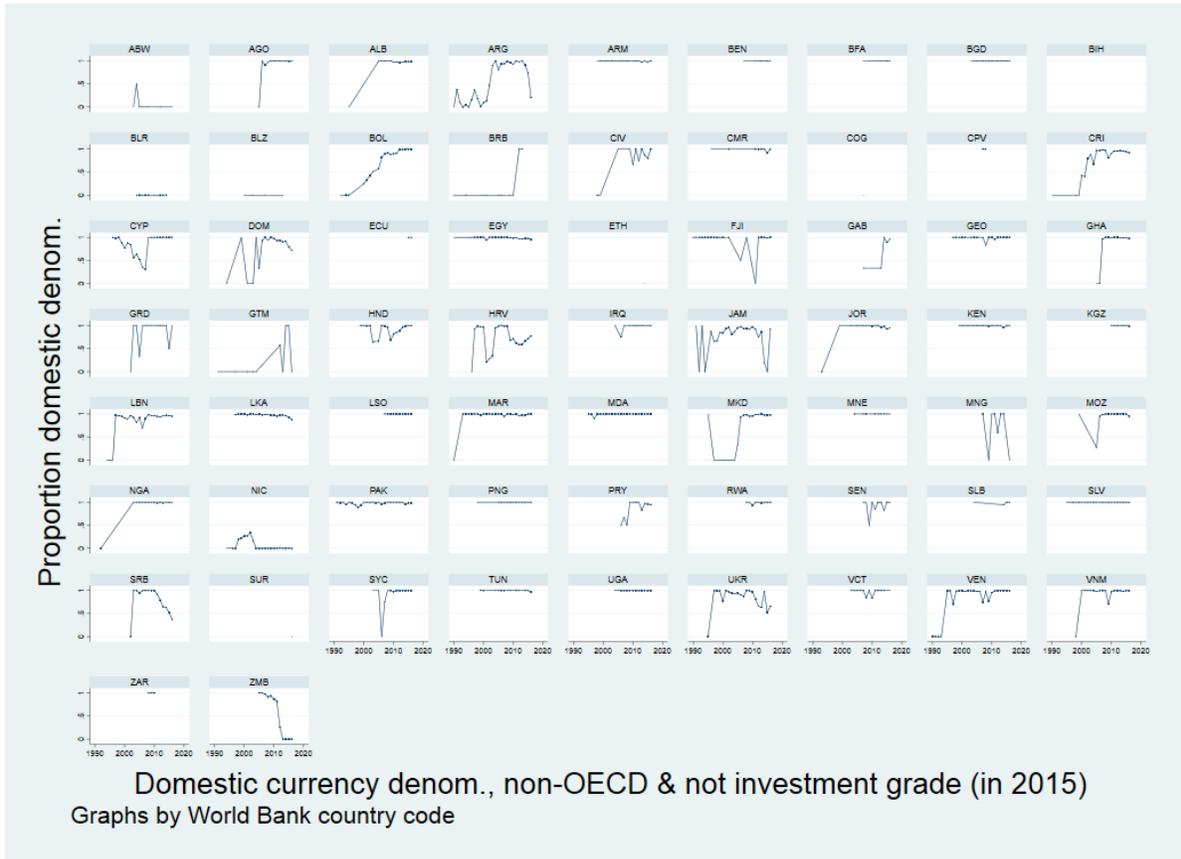


Figure A.10: Proportion of domestic-currency denominated sovereign bonds, for non-investment grade non-OECD countries.