1 *Introduction*

In 2001, Sufian Ahmed, Ethiopia's finance minister, confronted a vanishingly narrow set of options. For a developing country, Ethiopia carried a heavy public debt burden – government debt amounted to almost 100 percent of GDP – and could find few willing lenders besides the World Bank and the International Monetary Fund (IMF). The country's leadership, having taken power in the 1990s after sixteen years of civil war, had publicly rejected liberalizing reforms and instead advocated for active state intervention to deliver development. Now, facing a severe funding shortage and with few sources of financing, the country turned to donors to request debt forgiveness and a loan program. The 2001 agreements secured $150 million from the World Bank and $112 million from the IMF. The political price, however, was steep. The agreement with the World Bank included twenty-seven separate reform requirements, including preparing thirty-four state-owned companies for privatization, reducing the authority of the central bank, and restructuring the civil service. Given the government's political orientation, this was a difficult pill to swallow.

A mere twelve years later, Ethiopia's circumstances had changed dramatically. Still Ethiopia's finance minister, Sufian Ahmed now faced a different task: juggling negotiations with a diverse array of creditors in order to finance projects in Ethiopia. In 2013, the Ethiopian government signed an agreement with a consortium of Chinese banks for a $3.3 billion loan to fund a railway connecting the capital, Addis Ababa, to the port in neighboring Djibouti, giving landlocked Ethiopia a vital trade link. A year later, Sufian Ahmed's team traveled to London and New York to meet with private investors before issuing the country's first ever international bond in December 2014, raising $1 billion. At the same time, the World Bank continued to provide loans to the Ethiopian government, supporting the government's infrastructure priorities with more than $700 million in transport-sector projects in 2014.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

In little over a decade, Ethiopia went from being seen in Western capitals as a byword for famine and conflict with few credible funding options to borrowing from a diverse array of creditors. As one of the African continent's longest serving finance ministers, in office from 1994 to 2016, Sufian Ahmed personally witnessed this transformation. While Ethiopia is one of the starkest examples of the dramatic expansion of financing options between the early 2000s and the mid 2010s, the country's experience is part of a broader trend that saw African governments expand their access to external finance over this period.

In the late 1990s, the majority of African governments carried large public debt burdens and could find few financiers beyond Western donors and international financial institutions. By the 2010s, emerging donors, especially China, became prominent lenders to countries on the continent. In addition, private investors in international bond markets had become an important source of finance for many African countries. Governments that previously had few options could now assemble a diverse portfolio of external finance.

What happens when a government goes from having few choices for external funding to selecting from a varied menu of lenders? This book investigates if and when such access to a wider set of creditors increases a government's bargaining leverage with its existing donors. I argue that borrowing from a more diverse array of creditors enhances borrowers' negotiating power, giving them greater influence over the terms of aid they receive from traditional donors. Further, new borrowing relationships are most likely to enhance bargaining leverage with traditional donors if the recipient country is an important partner for the donor and if the donor trusts the recipient will uphold its aid agreements.

The empirical context for this analysis is specific to the early decades of the twenty-first century and the changing external finance portfolios of African countries during this time. However, the argument also speaks to long-standing questions in international politics on the relationship between interdependence and power. I argue that developing countries can extract negotiating leverage from their borrowing relationships with new creditors, a phenomenon I term the *financial statecraft of borrowers*. The reference to financial statecraft links my argument to broader claims that countries can use financial interdependence to their advantage, helping them to achieve foreign policy goals.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

However, the focus on borrowing countries sets this argument apart from most other research on power and financial interdependence. Rather than examining the bargaining leverage of strong states in the international financial system, I consider the bargaining leverage of the weak, namely developing countries that are often reliant on outside sources of finance. Unlike larger economies that exploit the dependence of other states to achieve foreign policy goals or even reshape global governance, borrowing governments exercise financial statecraft by using borrowing relationships to *reduce* their dependence on any one donor or creditor. This more modest application of financial statecraft highlights the possibility for developing countries to use asymmetric relationships of interdependence to their advantage.

Developing countries' ability to borrow from external creditors is determined largely by dynamics external to the borrowing government. For this reason, developing countries' access to external finance has tended to be cyclical, with expansion of lending during periods of abundant liquidity, followed by crises when finance becomes yet again more scarce. This cyclical pattern has played out in different regions over recent decades: Latin America in the 1970s and 1980s, East Asia in the 1990s, and more recently in sub-Saharan Africa in the 2010s. For African countries, the expansion of foreign finance brought opportunity but also enabled the accumulation of large debt burdens that made them especially vulnerable to crisis when the COVID-19 pandemic and global economic shutdown hit in 2020. This book focuses on the impact of the earlier phase of abundant liquidity on relations between governments and their creditors and donors, examining the upswing rather than the downswing of the global capital cycle. Nevertheless, better understanding the political dynamics during this phase of expanding credit also sheds light on how countries accumulated the debt that later left them vulnerable to crisis.

1.1 The Argument in Brief: The Financial Statecraft of Borrowers

The core argument of this book is that a wider and more diverse pool of creditors can increase borrowing governments' negotiating power with the industrialized countries and multilateral development banks that have traditionally provided the majority of foreign

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aid.[1] The outcome of interest in this study is the aid agreement between a developing country government and a donor, specifically the extent to which the agreement aligns with the interests of the recipient government. Aid agreements vary along several dimensions, both formal and informal. The most basic dimensions of aid agreements are the amount of aid that donors provide and which projects or programs will be funded with that aid. Moreover, agreements vary in the reform or performance conditions the recipient must meet to access the aid. Donor–recipient relationships also differ in their informal characteristics, with some involving extensive donor scrutiny of recipient policy. Fundamentally, donor–recipient relationships vary in the extent of influence that donors have on development policy in the recipient country.[2]

Variation in the terms of aid agreements is a central outcome in the literature on the politics of aid, with research seeking to explain why some countries receive aid on more generous terms than others. Much scholarship has attributed differences in aid agreements to donors' interests, demonstrating that donors extend more attractive aid to countries that are in some way important to donors. Most of this research has operationalized the generosity of aid in terms of the amount of aid that countries receive, revealing that donors allocate more aid to important trading partners,[3] countries that are more likely to generate spillovers for the donor,[4] major strategic partners, or past colonies.[5] Others have shown a relationship between donors' interests and the conditions attached to foreign aid, showing that the World Bank offers more flexible loans to developing countries that are more ideologically proximate to the United States.[6]

The argument in this book similarly seeks to explain variation in aid agreements. However, rather than explaining these differences primarily with reference to donors' interests, the argument of debt-based financial statecraft is that recipient countries' portfolios of external

[1] As a shorthand, I refer to advanced economy bilateral donors and the major multilateral donors, including multilateral development banks, as "traditional donors" or "donors."
[2] Swedlund 2017b, pp. 25–27.
[3] Barthel et al. 2014.
[4] Bermeo 2017.
[5] Alesina and Dollar 2000.
[6] Clark and Dolan 2020.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

finance can shape their bargaining power and thus the terms of the aid relationship. The expectation is that countries that broaden and diversify their sources of external finance, becoming less reliant on traditional donors, will secure more attractive terms in their aid agreements. The argument connects recipient countries' portfolios of external finance to the interests of donors in the "marketplace" of foreign aid to explain why some governments receive aid from traditional donors that is more aligned with their interests. My focus is on the impact of a broader range of external finance on governments' relationships with traditional donors, since the latter are the actors that long held a monopoly in the marketplace of foreign aid.

The argument proceeds in a number of steps. First, borrowing from alternate creditors reduces a government's reliance on traditional donors. Second, this reduced reliance encourages traditional donors to provide resources that are more in line with the government's preferences. Finally, some governments extract more leverage from their diversified portfolios of external finance than others due to donors' interest in the borrowing government and their trust that aid agreements will be upheld.

To illustrate the first step, take the example of the Zambian government, which in 2010 announced a $1 billion loan agreement with China to fund key infrastructure investments, followed the same year by a $2 billion agreement to develop a hydroelectric dam.[7] These commitments eased the government's dependence on traditional donors, including the World Bank, which funded infrastructure projects in road construction and electricity generation around this time. By diversifying away from previously prominent sources of financing, the Zambian government became less reliant on traditional donors to continue providing funds into the future. As one commentator noted, "The combined effects of less aid dependence and new donors imply that the impact of traditional aid and donor conditions now play a less significant role in Zambian public debate."[8]

The claim that borrowing from a wider range of sources lowers a government's reliance on individual donors or creditors may be uncontroversial. However, the second step of the argument, the impact of

[7] Kragelund 2014.
[8] Rakner 2012.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

this reduced dependence on the negotiations between the government and traditional donors, is more counterintuitive. Why would donors offer preferred terms to developing countries that are less reliant on their aid? Would donors not simply be happy that others are providing development finance and move on?

In fact, donors have good reasons to offer attractive terms to borrowing governments that reduce their dependence on donors' development finance: Donors have an interest in shaping recipient government policy, and development finance allows them to shape policy conversations with the recipient government.[9] Scholars have debated whether donor countries are motivated to provide aid out of an altruistic concern for developing countries or for self-interested foreign policy ends.[10] More recent scholarship suggests that bilateral donors act out of an enlightened self-interest, using foreign aid to encourage development with spillover benefits for themselves.[11] What is common across different motivations, however, is that donors seek to have some influence over the policy of recipient countries and that they gain influence in connection with the aid they provide.

Donors are therefore competing in a marketplace for foreign aid, seeking to provide attractive development finance that gives them access to and influence with the recipient government. Historically, major bilateral donors and multilateral development banks have largely had the same broad approach to development aid, even coordinating among themselves in their approach to recipient countries. As borrowing governments diversified their portfolios of finance, borrowing from China or in international bond markets, recipient countries became less reliant on these traditional providers of development finance. Since they operate within a marketplace for aid, I suggest traditional donors do not exit the market when confronted with recipients' greater autonomy but instead innovate and offer recipient governments aid closer to the latter's preferences. My contention that access to additional sources of finance strengthens the government's negotiating strength rests on insights from the bargaining literature on the benefits of outside options. By establishing new borrowing relationships,

[9] Whitfield 2009b.
[10] Alesina and Dollar 2000; Berthélemy 2006; Gulrajani and Calleja 2019; Schraeder et al. 1998.
[11] Bermeo 2017, 2018.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

developing countries can become more influential with their traditional donors. Recipient influence grows even though the government's new debtor relationships are unequal, with the government being far more reliant on China and private creditors than these creditors are on the borrower.

This claim distinguishes the financial statecraft of borrowers from alternative perspectives on developing countries' integration into the international economic and financial system, especially "dependency" style arguments. Dependency perspectives see developing countries' unequal integration into the international financial system as self-reinforcing. These theories suggest that exploitative and extractive relationships between rich and developing countries make it impossible for poorer countries to develop and instead perpetuate these countries' structurally weak position in the international economy.[12] My concept of debt-based financial statecraft does not deny that borrowing relationships are unequal nor claim that governments can overturn their structural position in the world economy. Instead, it highlights the potential for developing countries to use asymmetric financial ties as a basis for leverage, enhancing their power in negotiations with donors, relatively modest though this outcome is.

In stressing the benefits that developing countries can extract from their borrowing relationships, I draw on a tradition of scholarship on interdependence and economic statecraft.[13] Analysis of economic and financial statecraft has largely seen it as a tool of large and wealthy states, which can capitalize on the economic dependence of others by applying trade sanctions or restricting access to currency or financial systems.[14] While more recent work has expanded the concept to include defensive statecraft aimed at resisting foreign influence,[15] the focus has been on emerging economies that occupy increasingly prominent positions in the international financial system and can benefit from their greater size and centrality. By contrast, I analyze financial statecraft "from below," arguing that developing countries that rely on creditors for continued access to external finance can use these economic ties as a basis for leverage.

[12] Taylor 2014.
[13] Baldwin 1985; Hirschman 1945; Keohane and Nye 2001.
[14] Drezner 1999; Steil and Litan 2006.
[15] Armijo 2019.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

The final step of the argument is explaining why some governments are more likely to derive negotiating benefits from borrowing from alternative sources than others. I suggest differences across recipient countries are driven both by donors' interest in the relationship with the recipient government and donors' trust in the government's willingness and ability to uphold aid agreements. Donors are more likely to respond proactively to the government's reduced dependence on their aid if the relationship with this government is especially valuable, meaning alternative finance should do more to enhance the bargaining power of recipient countries when this is the case.

Separately, when considering whether to offer more attractive terms in response to a recipient country's diversified portfolio of finance, donors' trust in the government's credibility is key. Since government–donor negotiations are in large part over the extent of flexibility granted to the government in the implementation and oversight of development programs, donors' willingness to meet the government's preferences for flexibility depends on the extent to which donors trust that the government will uphold its part of the agreement. Moreover, if donors do not trust government institutions for implementing and overseeing development programs, they may also worry about the government's uses of alternative finance, fearing that this spending could put their own projects or repayment at risk. In these cases of limited donor trust, governments that borrow from alternative creditors may find donors to be even less accommodating, rather than finding alternative finance a useful source of bargaining leverage in aid negotiations. Donor trust in the recipient government can vary based on the government's past performance in implementing development programs or donors' appraisal of government institutions for budgeting and financial management. Moreover, I suggest that donors base their trust on the domestic politics in the recipient country, with greater distrust in countries where clientelist spending pressures or widespread corruption make the government's spending promises less credible.

1.2 Situating the Argument

This book's focus on how a government's portfolio of external finance impacts relationships with aid donors bridges the often separate literatures on the politics of international finance and development aid. It intervenes in debates about the consequences of a country's choice of

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creditors and the rise of emerging economies as donors and lenders. Moreover, it highlights the agency of African governments in navigating often asymmetrical relationships with foreign creditors and donors.

1.2.1 Countries' Choice of Creditors

In arguing that the composition of a developing country's set of creditors affects its relationship with aid donors, this book builds on research in international political economy on governments' choice of creditors. For a long time, the conventional understanding was that governments, especially developing country governments, exercised very little choice over who they borrowed from. In this understanding, developing countries are so reliant on international financial institutions and foreign creditors for access to finance that they will accept whatever aid or finance is offered to them, only really discriminating on price, preferring lower cost loans to more expensive ones.

However, recent research shows that governments, including those in developing countries, do make choices about when to borrow and who to borrow from.[16] In the most substantial contribution to this strand of research, Bunte (2019) examines the full range of financing choices available to developing countries in the contemporary era and theorizes the political underpinnings of governments' choice of loans from international financial institutions, traditional creditors, emerging economies, or private markets.[17] Bunte demonstrates not only that developing countries exercise agency over the composition of their debt, but also that this choice reflects the balance of political influence among domestic interest groups, representing finance, industry, and labor. Where finance and industry are most influential, for example, the government will prioritize private lenders.

I build directly on the work of Bunte and others to argue that the diversity of countries' portfolios of external finance matters for their negotiations with donors. I turn from governments' choice of creditors to the *consequences* of those choices, arguing that countries that diversify their portfolio of external finance can increase their bargaining leverage. Inspired by the literature on creditor choice, I bring together

[16] Ballard-Rosa et al. 2019; Cormier 2022, 2023; L. Mosley and Rosendorff 2023.
[17] Bunte 2019.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

the often separate literatures on debt and aid to argue that governments of developing countries choose from a broad range of external finance, extending from grant aid to market-rate loans. Considering this portfolio as a whole reveals how governments can spread their reliance for external finance from one set of donors to a broader range of creditors, reshaping their negotiations with donors.

1.2.2 The Rise of China as a Global Lender

The rise of China, and, to a lesser extent, India and Brazil, has reshaped the global landscape of development finance. As China's economy rapidly grew, various public agencies and banks – including the Ministry of Finance and Commerce, China Development Bank, and China Export-Import Bank – expanded overseas aid giving and lending, often connected to the larger policy of the Belt and Road Initiative. By some estimates, China had become the world's leading official creditor by the end of the 2010s.[18] Scholars have explained China's aid and loan programs as motivated by ambitions for greater influence in recipient countries,[19] a desire for increased international status,[20] or a mix of commercial and geopolitical objectives.[21] Public commentary about China's lending has sometimes raised the alarm that Chinese development finance supports authoritarian governments and undermines good governance advocated by traditional donors and that Chinese lending is an effort to entrap borrowing countries with unsustainable debts that allow China to exercise greater geopolitical influence.[22] However, there is little evidence of a deliberate strategic effort by China to ensnare borrowing countries with unsustainable debts, and Chinese lending seems largely to be motivated by commercial objectives.[23] Research unpacking the heterogeneity of Chinese finance reveals that the low-cost concessional funds most akin to foreign aid are allocated to poorer and more geopolitically aligned recipient countries, following similar patterns as traditional donors' aid allocation.[24] By contrast,

[18] Horn et al. 2021.
[19] Rotberg 2008; Taylor 2014.
[20] Armijo and Katada 2014.
[21] Brautigam 2011; Kaplan 2021.
[22] Chellaney 2017; Naim 2007.
[23] Jones and Hameiri 2020.
[24] Dreher et al. 2018.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

more expensive finance is allocated in line with commercial objectives, flowing to countries that are rich in natural resources and suitable for commercial projects involving Chinese firms.[25] The main motivation for Chinese lending appears to be cultivating closer diplomatic relations with borrowing countries and supporting Chinese firms in their expansion to new markets.

The feature of Chinese aid and loans that is most relevant for my argument is its relative flexibility compared with the aid and loans of traditional donors and international financial institutions, especially the lack of reform conditionality. Though funds from Chinese policy banks usually require the recipient government to procure goods and services from Chinese firms and are often priced close to market rates, with more expensive financial terms than traditional donors' development finance, they do not require the government to undertake institutional or policy reforms.[26] Moreover, given the commercial focus of much of this lending, Chinese loans are more likely to fund infrastructure projects.[27] Chinese lenders' approach and focus thus add diversity to the mix of development finance available to developing countries, giving them a greater range of choice.[28]

This book focuses on how the rise of China, among other alternative creditors, changes the bargaining relationship between recipient governments and traditional donors. As such, it builds on previous work that studies how traditional donors respond to the increasing volume of Chinese loans.[29] The results of this previous research cut in different directions, with some finding evidence that loans from nontraditional creditors alter traditional donor aid and others finding little effect. What I add to these analyses is a consideration of how Chinese loans fit within developing countries' broader portfolio of external finance, including private finance and foreign aid from traditional donors. Moreover, prior work has primarily focused on the potential for competition among donors.[30] By turning the lens to recipient governments and theorizing how external finance affects their

[25] Kaplan 2021.
[26] Hernandez 2017; Taylor 2011.
[27] Kaplan 2016; Zeitz 2021a.
[28] Greenhill et al. 2013; Kragelund 2012; Woods 2008.
[29] Hernandez 2017; Humphrey and Michaelowa 2019; Swedlund 2017a; Zeitz 2021a.
[30] Bueno de Mesquita and Smith 2016.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

reliance on traditional donors, this book sheds light on the conditions under which new development finance – including Chinese finance – is likely to affect traditional donors' aid.

1.2.3 Developing Countries and Private Finance

My account of debt-based financial statecraft builds on several strands of the literature on developing countries in the international financial system. One such strand examines the political consequences of debt composition and another focuses on the impact of sovereign debt on countries' policy autonomy and the cyclical nature of countries' access to private finance. While the emphasis of the creditor-choice literature on governments' preferences over the full range of private and public creditors may be quite recent, there is an earlier wave of scholarship that considers the political consequences of the composition of countries' debts to private creditors. In the 1990s, governments, including in middle-income countries, increasingly shifted their borrowing from a smaller set of banks to dispersed investors in international bond markets, with implications for their relationships with creditors. Copelovitch (2010) finds that countries with higher levels of bond debt received larger but more stringent IMF programs, which the Fund deemed necessary to restore access to bond markets. I build on this work on debt composition, arguing that access to private external finance reshapes countries' relationships with their traditional donors.

Separately, a long-standing debate in international political economy examines the constraints that bond markets impose on borrowing countries' policy choices.[31] While advanced economies appear to have maintained substantial policy discretion despite borrowing in international markets, developing countries are more likely to face bond market discipline in response to policies, or political orientations, that investors fear will put repayment at risk.[32] It may therefore be surprising to argue that private finance acts as a flexible alternative to traditional aid that gives borrowing governments greater autonomy in negotiations with traditional donors.

[31] Drezner 2001; Garrett 1998; L. Mosley 2000; L. Mosley et al. 2020.
[32] L. Mosley 2003; Wibbels 2006.

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However, I draw on research on global liquidity cycles and developing countries' market access to argue that during phases of widespread lending, investors exercise less scrutiny, even of developing countries.[33] Shifting global allocations of capital in the period after the 2007–2008 global financial crisis gave poorer developing countries, including many African ones, access to international bond finance for the first time. Investors' exuberance and search for returns gave governments access to finance that, while more expensive than traditional donor aid, had no formal performance or reform requirements.[34] In this way, bond market finance gave governments greater autonomy and potentially greater bargaining leverage with traditional donors.

1.2.4 Foreign Aid, Negotiations, and the Donor–Recipient Relationship

I pick up an important insight from the literature on aid agreements, which emphasizes that aid agreements are the outcomes of negotiation. If development aid is understood as a form of charity or a purely humanitarian undertaking, it can be surprising to describe that aid as the outcome of bargaining. However, even if donors and the recipient government share an interest in economic development, their bureaucratic structures, ideological orientations, or broader policy objectives can lead them to have diverging preferences that must be reconciled through negotiation. Whitfield and Fraser (2009) and Swedlund (2017b) each analyze aid agreements through the lens of negotiation, arguing that donors and recipients draw on available resources to influence the design and implementation of aid agreements in line with their preferences. Drawing on these claims, I argue that for developing countries, new borrowing relationships are a resource they can use to increase their bargaining leverage in negotiations over aid.

Within development policymaking, a preoccupation of the last decades has been the extent to which donor-funded projects support the domestic policy priorities of recipient countries. Responding to concerns about the ineffectiveness of aid, in the 2000s the development community declared in the Paris Declaration on Aid Effectiveness that donors should "align behind [recipient countries'] objectives and use

[33] Ballard-Rosa et al. 2019; Bauerle Danzman et al. 2017; Naqvi 2018.
[34] Cormier 2023; Zeitz 2021b.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

local systems."[35] However, as critics pointed out when these new principles were introduced, the push toward "alignment" offered a mostly bureaucratic solution to a political challenge, namely that recipients and donors can have divergent preferences and that recipients are often reliant on donors, allowing donors to advance their own interests.[36] By analyzing whether access to alternative finance allows recipient governments to push for their preferred outcomes, this book responds to a gap in the policy proposals for aid alignment, examining the political preconditions that enable recipients to achieve negotiating outcomes that are more consistent with their preferences.

1.2.5 African Foreign Policy and the Politics of Extraversion

While my argument about how borrowing relationships affect aid negotiations is a general one, the empirical context in which I develop and test the argument is specific to sub-Saharan Africa in the early decades of the twenty-first century. I focus on countries in the region because, as I explain later in this chapter, the transformations in African countries' access to external finance were abrupt and dramatic, providing an ideal setting to compare an earlier reliance on traditional donor funds to a later diversity of external finance. Moreover, the literature on African politics and international relations has insights for how governing elites can use external ties to their advantage. The literature on "extraversion" in African politics argues that political elites in postcolonial African countries have used relationships with foreign entities – former colonial powers, international organizations, and multinational firms – to achieve personal and political aims.[37] Peiffer and Englebert (2012) conceptualize African governments' different forms of engagement with the outside world as an "extraversion portfolio" and argue that countries with narrow extraversion portfolios, for instance those that depend on a single donor, are less effective at resisting pressures for institutional reform.

This approach is helpful for my analysis, highlighting how ties of seeming dependence, such as an increasing reliance on China for bilateral loans, can be a potential source of strength. While I am more

[35] OECD 2005.
[36] Chandy 2011; Rogerson 2005; Sjöstedt 2013.
[37] Bayart 2000, 2009; Clapham 1996.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

focused on the implications of diversified finance for borrowing governments, rather than individual elites, I take from the literature on extraversion a focus on African states' agency in managing financial interdependence. On its own, however, an extraversion framework offers little account of how external actors are likely to respond to strategies of extraversion or when these efforts are likely to be successful. To understand how African governments' access to alternative forms of finance affects their relations with donors, one also needs an understanding of these donors' and creditors' motivations. My argument brings together donor and recipient motivations to understand how negotiations change under conditions of diversified finance.

1.3 A Diversified Portfolio of External Finance

While I focus my analysis of debt-based financial statecraft on sub-Saharan Africa[38] in the first decades of the twenty-first century, earlier phases of financial globalization saw other regions gain access to diverse sources of finance. From the late 1960s onward, developing countries in Latin America expanded their access to private finance, experimenting with "indebted industrialization" while they benefited from easy credit from recycled petrodollars and private lenders.[39] Many of these countries subsequently experienced debt crises when access to finance dried up and accumulated debt burdens proved too much to carry.[40] This historical parallel invites caution about the long-term economic sustainability of countries relying on private and market-rate finance, since the accumulation of expensive debt makes countries especially vulnerable to shocks. However, the focus of this book is not on the macroeconomic consequences of external borrowing, but rather on how borrowing in a time of plenty affects countries' foreign relations, specifically their relations with foreign donors.

[38] Regional boundaries necessarily entail somewhat arbitrary distinctions. I focus on sub-Saharan Africa and exclude North African countries in line with the common practice of international development agencies. This distinction follows on from different legacies of colonialism and decolonization, as well as differences in contemporary patterns of integration into the international economy.
[39] Devlin 1990; Frieden 1981.
[40] Frieden 1991.

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For governments in sub-Saharan Africa, the expansion of financing options in the 2000s and 2010s was especially pronounced when contrasted with countries' earlier reliance on foreign aid from traditional donors. The greater array of financing options available to these countries was the result of three developments: widespread debt forgiveness, China's rise as an official lender, and abundant global liquidity that led private investors to lend to "frontier markets."

More than half of all sub-Saharan African countries received debt relief from international financial institutions and bilateral creditors in the 2000s.[41] Most African countries had accumulated large public debt burdens in the 1970s and 1980s, due to limited accountability for either borrowing governments or official lenders, extensive bilateral lending by advanced economies, and price shocks to resource exports that left government coffers empty and countries getting by on credit. By the 1990s, African governments had amassed large volumes of external debt, most of it owed to public lenders, for which they negotiated repeated payment extensions and delays. After concerted activist campaigns, Western governments and international financial institutions confronted the reality that developing countries' debt service was hampering economic development.[42] In 1996, multilateral institutions and creditor countries began a decade-long process of writing off portions of the debt of thirty-nine highly indebted poor countries, of which more than thirty were in sub-Saharan Africa.

Due to debt relief and the economic growth experienced by many African countries in the 2000s, the external debt of sub-Saharan African countries declined from a height of an average of 115 percent of GDP in 2000 to 41 percent of GDP in 2010 (see Figure 1.1). The substantial reductions in public debt made African governments more attractive to potential lenders. It may be surprising that debt relief enabled governments to borrow, if debt cancellation indicated that borrowers had been unable to meet their debt obligations. Yet, debt relief was explicitly framed as a one-time reduction in unsustainable and unproductive debt, with the intention of freeing up borrowing space for future loans.

The second phenomenon that dramatically increased the availability of external finance to African governments in the 2000s was the

[41] Birdsall et al. 2002; Bunte 2018.
[42] Blackmon 2017; Busby 2007.

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Figure 1.1 Average government debt in sub-Saharan Africa (% of GDP), 1975–2018.
Source: IMF Global Debt Database.

rise of emerging economies as bilateral lenders.[43] Brazil, China, India, Turkey, and various Gulf States all increased their loans to developing countries over the course of the 2000s (see Figure 1.2). Of these emerging lenders, China provided by far the largest amount of financing, using foreign exchange earnings accrued during decades of export-led economic growth to fund its lending program and deploying loans to support domestic firms' interests abroad.[44] Though other emerging donors may become more important in the future, China has been the only meaningful global alternative to traditional lenders and therefore this book focuses on China as the prominent new bilateral lender. While China has extended aid and loans to countries all over the world, sub-Saharan Africa has received the largest share of Chinese finance. Given sub-Saharan governments' previous dependence on traditional donors, the availability of Chinese aid and loans marked a stark change.

The third and final development reshaping African countries' access to external finance in 2000s and 2010s was international bond

[43] Brautigam 2011; Horn et al. 2021; Mawdsley 2012.
[44] Dreher et al. 2022; Horn et al. 2021; Kaplan 2021.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

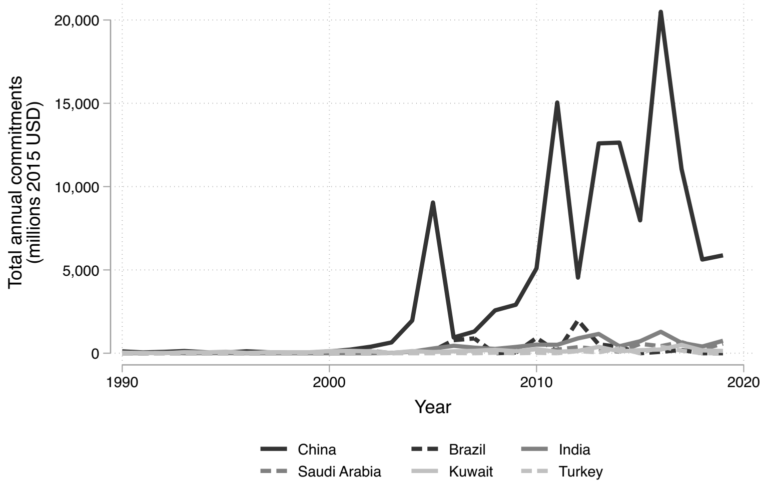

Figure 1.2 Nontraditional bilateral lenders' total annual commitments to sub-Saharan African countries, 1990–2019.
Source: World Bank International Debt Statistics.

markets investors' newfound willingness to lend to African governments.[45] As the yields on government bonds of wealthy countries plummeted with the accommodating monetary policy adopted during and after the global financial crisis (2007–08) and the Eurozone crisis (2009–mid 2010s), bond investors went on a "search for yield," looking for assets that would still generate sizable returns. Investors became willing to lend to first-time and riskier borrowers, dubbed "frontier markets." This greater risk appetite meant that investors exercised less scrutiny over institutions and policies in borrowing countries. Before this change in investor sentiment, the only sub-Saharan African country that had borrowed in international bond markets was South Africa. By 2018, sixteen African countries had issued international bonds (see Figure 1.3). Many of these countries issued repeatedly, returning to markets a number of times to take advantage of attractive interest rates. Not only were African governments able to borrow in global bond markets from which they had previously been excluded, but they also borrowed at appealing interest rates. As the *Financial Times* noted when Ethiopia issued its debut bond in 2014, the "relatively low yield

[45] Mecagni et al. 2014; Tyson 2015.

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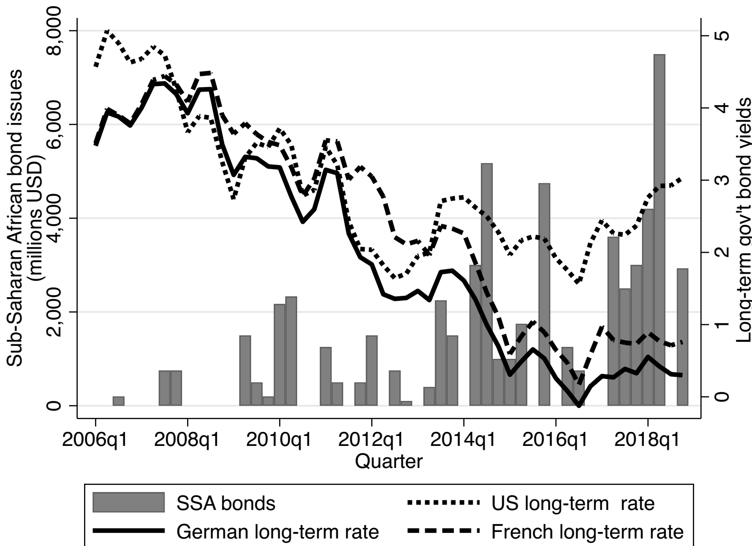

Figure 1.3 Quarterly volume of bond issues by sub-Saharan African countries and long-term yields of leading advanced economies, 2006–2018.
Sources: Capital IQ Database, *Bloomberg, Financial Times, Reuters*; Federal Reserve Bank of St. Louis.
Figure reproduced with permission from Zeitz (2021b) © Cambridge University Press.

of 6.625 per cent … shows how years of ultra-lax monetary policy in the US, Europe and Japan is allowing countries on the fringes of the frontier market category to tap the international capital market at relatively low cost."[46]

The cumulative impact of these three trends – debt forgiveness, the rise of Chinese lending, and access to international bond markets – has been that traditional development finance, from bilateral donors in the Organisation of Economic Cooperation and Development's Development Assistance Committee (OECD DAC), the World Bank, and other multilateral development banks, has decreased as a share of developing countries' external finance. Figure 1.4 reports snapshots of low- and middle-income countries' composition of external finance in 1990, 2005, and 2018. The figure shows that traditional sources of external finance have been displaced by the two major alternative sources

[46] Blas 2014.

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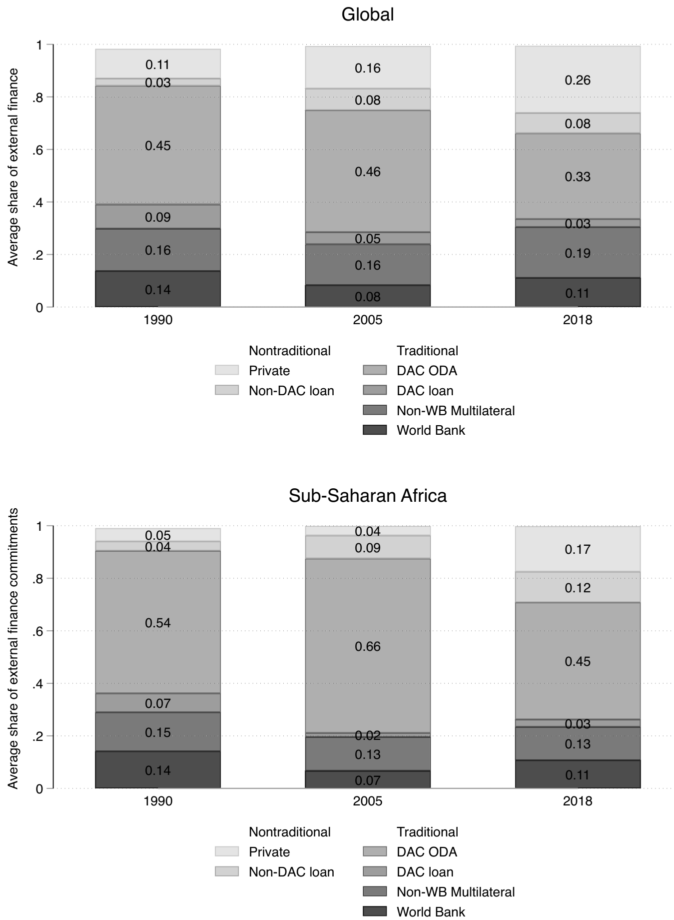

Figure 1.4 Average shares of external finance commitments by creditor and donor type in 1990, 2005, and 2018.
Sources: World Bank Debtor Reporting System; OECD Creditor Reporting System.

of finance: private loans and credit from non-DAC countries, primarily China. Globally, private finance has been the most important new source of finance for developing countries, increasing from an average of 11.3 percent of total external finance in 1990 to 25.5 percent of total external finance in 2018. For African countries, the rise of non-DAC lending has also been important in expanding the portfolio of external finance, with the share of finance coming from non-DAC

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

lenders increasing from an average of 3.7 percent in 1990 to 11.7 percent in 2018.

Debt relief, China's loan program, and increased private lending were global trends. Nevertheless, there are good reasons to focus on the change in bargaining relationships in the African context. First, the increase in available finance was most dramatic for African countries. They were the greatest beneficiaries of debt relief and received the majority of Chinese-financed projects. Though developing countries in other regions were also able to borrow at attractive rates in international bond markets, sub-Saharan Africa had the largest number of first-time issuers during the bond boom. Furthermore, African governments' negotiations with traditional donors are a hard test of the argument that borrowing from alternate sources enhances negotiating power, since the agency and capacity of African governments is often assumed to be low, especially in relations with donors and creditors.[47] If these governments have been able to convert their greater variety of creditors into negotiating strength, it is likely that other governments also have this ability.

Moreover, the period from 2000 to 2018 is attractive for studying the consequences of countries' borrowing choices, since the increase in amount and diversity of finance was largely determined by factors outside of African governments' control. While not all African countries borrowed in global bond markets and China lent more to some African borrowers than to others, the transformation in available finance was the outcome of forces not under the direct influence of African governments. Similarly, governments had to meet set criteria to qualify for debt relief, but the timing of debt reduction was set by the schedules of global debt relief initiatives and almost all countries assessed as having unsustainable debt burdens were granted relief. The fact that the availability of finance was largely shaped by external shocks makes it easier to evaluate whether the diversity of a given government's creditors has an impact on the government's negotiating power, since it is less likely that a government's ability to attract varied sources of external finance is a function of the same underlying capacity that makes it more effective at negotiating with donors.

The year 2000 marks the beginning of this time of expanded access to finance. The Jubilee campaign for debt relief called for developing

[47] W. Brown and Harman 2013; Mohan and Lampert 2012.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

countries' debt to be canceled by the start of the new millennium, and though debt relief fell far short of this goal, 2000 was a turning point in bilateral and multilateral debt relief efforts.[48] The dawn of the millennium also saw an initial increase in Chinese lending. In 1999, China announced its "Going Out" strategy, which heralded a step-change in China's overseas financing efforts.[49]

Two decades later, the window of opportunity for borrowing governments appeared to be closing. In March 2018, the IMF released a report sounding the alarm that low-income countries faced an increased risk of debt crisis, in large part due to new, commercial sources of finance.[50] A year later, the Chinese government announced debt sustainability concerns for a number of borrowers, saying it would adopt international standards on project screening and preparation in response, suggesting a slowdown in Chinese lending and potential convergence in official creditor practices and potentially reducing the diversity of financing.[51] Moreover, the volume of Chinese bilateral lending declined after 2018, as an economic slowdown in China combined with borrower repayment difficulties to lead to fewer loan agreements.

The final and unexpected shock that brought the period of plenty to an end came in 2020, when the COVID-19 pandemic plunged the global economy into turmoil. Countries that had accumulated large amounts of debt in the preceding decades were especially vulnerable to the sudden stop of capital flows to developing countries prompted by the economic shutdown. Within months of the onset of the pandemic, Zambia defaulted on its bond debt, becoming the first African country to default in the pandemic era.[52] Analysts that had cautiously warned of debt accumulation in the years leading up to the pandemic now worried about a full-blown debt crisis.

The expansion of credit to African governments in the 2000s and 2010s made debt-based financial statecraft possible, offering a window of opportunity in which new creditors were an alternative to traditional donors, increasing governments' autonomy and potentially

[48] Busby 2007.
[49] Fuchs and Rudyak 2019.
[50] IMF 2018.
[51] Dreher et al. 2022.
[52] Smith 2020.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

their bargaining strength. At the same time, the accumulation of debt made countries more vulnerable to crisis. The fragility of countries that expanded and diversified their portfolio of external finance makes clear the economic and political risks associated with this strategy. As the head of the World Bank's economic forecasting unit observed in 2022, "Market access is a wonderful thing to have when there is cheap money out there, but there might be a different view as conditions tighten."[53] By focusing on the consequences of diversified finance during a time of plenty, this book can also help explain why countries accumulate debt burdens that leave them vulnerable in a downswing of the global capital cycle.

1.4 Contributions

This book contributes to the literature on economic interdependence, international finance, and development aid. It argues that countries can – under certain conditions – use asymmetric interdependence to their advantage and shows this phenomenon at work. Expanding the understanding of the consequences of economic interdependence for developing countries thus constitutes the book's first contribution. Without being overly sanguine about the terms on which developing countries are integrated into the international financial system, the book suggests these countries can benefit from relationships of asymmetric interdependence. Specifying and illustrating how developing countries can use these tools, despite their weaker position in the international economy, advances scholarship on economic and financial statecraft. The analysis of African countries' debt-based financial statecraft opens the way for other analyses of countries using asymmetric interdependence to their advantage.

Second, by drawing attention to the role of private finance in developing countries' portfolios of external finance, this book contributes to a growing literature on systemic dynamics in international political economy.[54] Changes in the composition of global capital flows have knock-on effects, including for crisis management and political development.[55] In this case, the rise of private finance for African borrowers

[53] Wheatley 2022.
[54] Ballard-Rosa et al. 2019; Bauerle Danzman et al. 2017; Oatley et al. 2013.
[55] Copelovitch 2010; Queralt 2022.

https://doi.org/10.1017/9781009475075.001 Published online by Cambridge University Press

was caused in large part by investors' greater risk acceptance during a phase of loose monetary policy in advanced economies. The evidence in this book points to a surprising spillover of advanced economies' monetary policy, namely that it enhanced developing countries' bargaining power with donors. More broadly, the book highlights the importance of systemic factors – global liquidity conditions, the rise of emerging powers, and the composition of global capital flows – in shaping donor–recipient negotiations.

Third, the book examines the effect of countries' *portfolios* of external finance, reflecting the full diversity of developing countries' sources of external finance, from grant aid to market-rate loans. The literatures on sovereign debt and foreign aid have largely evolved separately, since the motivations of lenders and donors are very different. The former are primarily interested in being repaid, while the latter are interested in development outcomes and dialogue with the recipient government. And yet, from the perspective of a recipient government, loans and aid are different ends of the same spectrum, with trade-offs between them. By investigating the consequences of diversity within the portfolio of external finance, this book adds to a growing literature on borrowing governments' agency in choosing among sources of external finance.

Finally, with respect to foreign aid and development policy, the book describes the consequences of a more diverse financing landscape from the perspective of recipient countries. Much scholarship and commentary has focused on the emergence of new donors, but a large share of it has focused on the motivations and behaviors of these new donors or the implications of their emergence for traditional donors.[56] By contrast, this book builds on research on countries' choice of creditors and turns the focus to recipient governments themselves, identifying how the rise of new donors affects their negotiating leverage.[57] This focus on borrowing countries enriches our understanding of the changing development finance landscape and economic multipolarity, contributing perspectives from outside the expanding core of the international economy.

[56] Dreher et al. 2018; Strange et al. 2017; Swedlund 2017a.
[57] Bunte 2019; Greenhill et al. 2013.

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1.5 Plan of the Book and Preview of Findings

The book is structured as follows. **Chapter 2** presents the theoretical argument. It explains how donor and recipient preferences interact in negotiations over foreign aid and outlines the argument that borrowing from alternative creditors can increase a recipient government's leverage in aid negotiations. I describe the mechanism underpinning the financial statecraft of borrowers, namely that recipients' reduced reliance induces donors to offer more attractive aid, and contrast it with alternative arguments based only on geopolitical competition among donors. Moreover, I develop my argument for when developing countries are most likely to benefit from relations with new creditors in their negotiations with traditional donors, which is when a donor especially values the relationship with the recipient government and when donor trust in the recipient is high. When these two conditions – importance to donors and donor trust – align, and a developing country diversifies its portfolio of external finance, then the recipient government is likely to be able to shift the relationship with traditional donors in line with its preferences.

To test this argument, the book combines different sources of evidence across the remaining chapters. Cross-national data on aid flows from OECD bilateral donors and major multilateral donors allows for tests of the association between a recipient country's portfolio of external finance and the terms of their aid from traditional donors, as well as tests for heterogeneity based on recipient importance and donor trust. I complement this analysis with three in-depth case studies of Ethiopia, Kenya, and Ghana, in which I trace how the agreements reached with donors did, or did not, change as the country diversified its sources of finance.

The statistical analysis is reported in **Chapter 3**. The chapter first provides an overview of the changes in developing countries' portfolios of external finance from the 1990s to the late 2010s, demonstrating that while countries in sub-Saharan Africa continued to receive large volumes of traditional aid, these countries also experienced the greatest reduction in their reliance on traditional sources of development finance. Drawing on this data, I assemble indicators of developing countries' reduced reliance on traditional donors, measured as the share of a country's total external finance coming from China, private

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creditors, or both. To capture outcomes in the relationship between developing countries and traditional donors, I use three measures: the total volume of aid provided by a donor to a recipient, the share of donor aid allocated to the infrastructure sector, and the number of conditions attached to World Bank projects. I show that developing countries that increase the share of finance coming from alternative creditors receive higher volumes of aid from traditional donors, more infrastructure funding, and fewer conditions attached to aid. These broad patterns hold across developing countries but are most pronounced among sub-Saharan African countries. To investigate heterogeneity among developing countries, I use measures of recipient country importance, namely temporary UN Security Council membership and the presence of US military bases, as well as donor trust in the recipient, including budgeting performance scores, corruption perception, and a categorization of the recipient country's political settlement. The results indicate that recipient importance, and especially donor trust, lead to a stronger association between borrowing from alternative creditors and more generous aid terms.

Having shown that borrowing from alternative creditors is associated with preferred aid terms across developing countries, I turn to the case studies to test the mechanisms by which this happens. **Chapter 4** introduces the comparative case analysis, explaining the rationale for case selection, describing the approach to data collection, and providing context on each of the three cases. I focus on three countries – Ethiopia, Kenya, and Ghana – that all borrowed from China and in international bond markets.

I selected these cases based on two attributes that, in my argument, should enable debt-based financial statecraft: significance to donors and donor trust in recipient credibility. There is variation across and within the three countries on these attributes in the period between 2000 and 2018. Broadly, Ethiopia was a case with high importance to donors and high donor trust, while Kenya was characterized by high importance and low donor trust, and Ghana was of declining importance to donors and had low donor trust. Variation in these perceptions over time and across different donors generates different combinations within each case that reveal how recipient-country attributes interact with the recipient's portfolio of external finance to shape aid negotiations. Though none of the case study countries is solidly in the category of low importance and high trust, one or another of the cases does

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hold this status with certain donors at specific points in time, as with donors in Ethiopia that are less sensitive to the country's geopolitical importance, or donors in Ghana that were less distrustful of the government's credibility. Comparison across the cases and over time thus tests expectations about conditions that enhance or inhibit debt-based financial statecraft.

Analysis within each case tests the mechanism at the heart of debt-based financial statecraft, investigating whether borrowing from alternative creditors altered the donor–recipient relationship because the government reduced its reliance on traditional donors and donors were willing to accommodate the government's preferences to retain the relationship. The data for this analysis comes largely from interviews with government and donor negotiators conducted during fieldwork research in Accra, Nairobi, Addis Ababa, New York, and Washington D.C. in August–October 2013 and January–August 2017. More than 170 elite interviews reveal aspects of aid negotiations that are not always documented in official publications, allowing me to trace how the dynamics and outcomes of negotiations shifted as the governments borrowed from alternative creditors.

A benefit of the case studies for the research design of the book is that they allow for a more fine-grained measure of the outcome variable. To best capture the outcome of interest – the extent to which aid agreements align with the recipient government's preferences, rather than donors' interests – it is necessary to identify the recipient government's priorities and which areas of recipient–donor negotiations were most contentious. In each of the cases, I draw on interviews, public documents, and media reporting to ascertain which areas of negotiations were the most sensitive and what each side's preferred outcomes would have been. I then trace outcomes in these issue areas over time, identifying whether variation in the outcomes is attributable to the recipient government's reduced reliance on donors and to donors' assessments of the recipient's importance and the credibility of recipient commitments.

In broad terms, three issue areas recurred in negotiations across all the cases: governance and democratization, macroeconomic and development policy, and financial management. Table 1.1 shows the pattern of outcomes across the cases in these three areas. In Ethiopia, where all three areas were contentious in negotiations with donors, the government was largely successful in aligning the terms of aid agreements

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Table 1.1 *Main negotiation areas and outcomes across the three cases*

Issue	Ethiopia	Kenya	Ghana
Governance and democratization	⇑	⇑	
Macroeconomic and development policy	⇑		⇓
Financial management	⇑	⇓	⇓

Outcomes are denoted as follows:
⇑ indicates an outcome aligned with recipient government preferences.
⇓ indicates an outcome diverging from recipient government preferences.

with its interests during the period when it enjoyed the greatest access to alternative finance. As reported in the Ethiopian case in **Chapter 5**, these outcomes were sometimes informal, as when donors avoided discussions over issues of governance and democratization to avoid antagonizing the government, and other times formal, as when donors agreed to fund the construction of industrial parks that were core to the government's development plans. The Ethiopian government's relative success in shifting the relationship with donors in line with its interests during a time of diversified finance was largely due to the significance donors attached to their relationship with the government, as well as donors' confidence that the government would adhere to aid agreements.

The Kenyan case, presented in **Chapter 6**, shows an uneven track record of debt-based financial statecraft. Here, the issue areas where donors and the government were far apart were governance and democratization, as well as financial management. While donors moderated their criticism of governance issues in an apparent response to the government's increase in borrowing from alternative sources, donors did not accommodate the government's preference for flexibility around financial management. These differences across issue areas are attributable to donors' assessment of Kenya's strategic importance and their concerns about the government's credibility in upholding aid agreements and development plans. For most donors, especially large bilateral donors, Kenya is an important regional security partner. These donors were especially sensitive to Kenya's reduced reliance on donor funds and inclined to moderate their stances on governance issues in response. When it came to financial management, however, Kenya struggled due to limited donor trust in the government's credibility.

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Although Kenya diversified its portfolio of external finance and articulated a preference for greater donor flexibility on financial management issues, donors were reluctant to accommodate this preference because of their concerns about corruption and weak institutional capacity.

In Ghana, the government had even more difficulties than the Kenyan government in translating its access to alternative finance into preferred outcomes in negotiations with traditional donors. As described in **Chapter 7**, the main areas of negotiation between the government and donors were over macroeconomic and development policy and financial management. Though the government secured a few victories in traditional donor support for priority development projects as it diversified its external finance to include Chinese loans and bond market finance, it ultimately struggled to shift relations in line with its preferences, with donors at one point withholding their aid funds to persuade the government to accept economic reforms. Despite reducing its reliance on traditional donor funds, Ghana did not see a consistent increase in its negotiating leverage with donors because of the country's reduced importance to donors and donors' concerns about the government's credibility. Historically, Ghana's close relationship with traditional donors has been buoyed by the strength of Ghana's democratic institutions and its progress in economic reforms. When donors attributed Ghana's economic crisis to government mismanagement, the country's symbolic value to several donors began to wane, leading those donors to place less of a priority on maintaining favorable relations with the government. Moreover, donors' lack of trust in the credibility of the government's commitments made them cautious about meeting the government's preferences for flexibility with respect to economic policy and financial management, despite the government's increasing autonomy from donor funds.

The conclusion in **Chapter 8** draws together the evidence from across the case studies and the quantitative analysis and provides additional illustrations of debt-based financial statecraft in Uganda, Senegal, and Laos. The conclusion highlights implications for policymakers, both in developing countries and in donor agencies. The findings indicate that governments that cultivate greater donor confidence will have more success in translating alternative finance into bargaining leverage. Moreover, the case studies highlight the benefits of a clear strategy for the diversification of external finance and a deliberate negotiation approach that deploys any increased bargaining

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leverage for specific priorities. For donor officials, the findings suggest the benefit of identifying areas where donors can be especially valuable to recipient governments, which can include specializing in distinct market niches.

The conclusion ends with a reflection on future prospects for debt-based financial statecraft. The period of expanding finance in the 2000s and especially the 2010s has been followed in subsequent years by sharp contractions in lending, government defaults, and fears of a widespread debt crisis in the developing world. I suggest that while some of the lessons from a time of abundance are transferable to a time of scarcity, debt crises also reveal the risks and possible limitations of debt-based financial statecraft. Moreover, to appropriately address the realities of countries' diverse portfolios of external finance in a time of vulnerability to debt crisis, the sovereign debt regime will need to be broadened and strengthened.

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