The Rise of Patient Capital:
The Political Economy of Chinese Global Finance

Stephen B. Kaplan
George Washington University
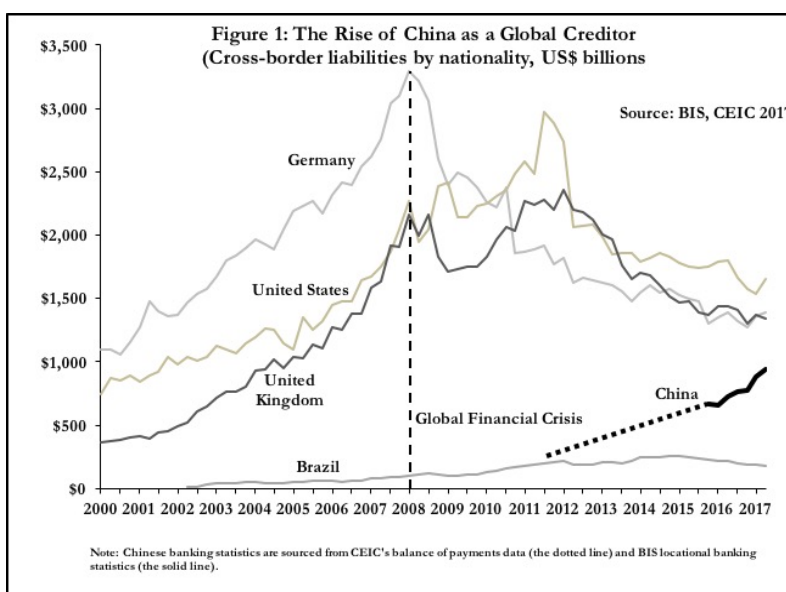
February 1, 2018

Abstract

As the United States has retreated from its lead role in globalization – first because of the 2008 financial crisis, and now under President Donald Trump's leadership – China has become a major global financial player. China, as the world's largest saver, has rapidly expanded its cross-border lending since the crisis, more than doubling its overseas banking presence. What are the implications? I contend that China's state-led capitalism is an important form of patient capital, characterized by a longer-term horizon. While technically classified as mobile capital, its higher risk tolerance and geopolitical shrewdness make state-owned capital less likely to swiftly exit debtor countries. Compared to traditional mobile capital, debtor governments thus gain more policy freedom, particularly during hard times when Western creditors might otherwise impose austerity and other onerous policy conditions. Employing an originally constructed dataset, the *China Global Financial Index*, I conduct an econometric test across 15 Latin American countries from 1990-2015. I find that Chinese state-to-state lending reduces governments' reliance on conditionality-linked Western financing, giving them more autonomy to use budget deficits to intervene in their economies. This effect is also contingent on partisanship, with extreme, or populist left governments being most likely to enhance their budgetary discretion. These results suggest that Chinese financing could be a development opportunity, but only if governments invest wisely. Otherwise, by lending without policy conditions, China may be encouraging developing country governments to spend without bounds, sowing the seeds for future debt problems.[1]

Word Count: 11,702 words.

1 Introduction

With Western capital reeling from the global financial crisis, state-owned capital made historic inroads globally. China, as the world's largest saver, rapidly expanded its cross-border lending, more than doubling its overseas banking presence. Today, China's global lending continues to increase at a blistering US$100 billion pace annually, putting the country on the brink of becoming one of the top five countries for international bank lending (see Figure 1).[2] In line with these trends, President Xi Jinping boldly promised to make China a "leading world power" by 2050 during the Communist Party's 19th National Congress. "Blazing a new trail for other developing countries to achieve modernization," President Xi declared that China "offers a new option for other countries who want to speed up their development while preserving their independence."[3]

Figure 1: The Rise of China as a Global Creditor (Cross-border liabilities by nationality, US$ billions

Note: Chinese banking statistics are sourced from CEIC's balance of payments data (the dotted line) and BIS locational banking statistics (the solid line).

Is President Xi correct that China represents a development opportunity? How does China compare to other global creditors? Is China's state-led financing distinct from other forms of mobile capital, particularly the portfolio inflows that have dominated cross-border investment into developing countries in recent decades? From Argentina to Greece, such mobile capital has tended to constrain autonomy, often compelling governments to implement austerity across the globe. Might Chinese finance mitigate such globalization pressures, upending longstanding tensions between mobile capital and national autonomy?

---

[2]China surpassed Switzerland as the 6th largest creditor in the international banking system in 2017, leaving only the United States, Japan, France, Germany, and the United Kingdom with a larger global banking presence (BIS Locational Banking Statistics 2017).

[3]Xinhuanet, October 18, 2017 (http://news.xinhuanet.com/english/2017-10/18/c_136688475.htm)

Similar to market-based creditors, Chinese financiers are also concerned with debt repayment. However, I claim that their lending often takes the form of patient capital, characterized by a long-term horizon and high risk tolerance. By comparison, portfolio investment has a short-term horizon that reflects bond and equity investors' tendency to scrutinize asset performance relative to quarterly and annual benchmarks.[4]

This short-term market financing creates a mismatch for debtor governments whose economic goals are often long-term. The danger of this mismatch is that it can foment boom-bust credit cycles.[5] Capital can exit suddenly when sovereign assets underperform, creating destabilizing credit shocks that jeopardize sustainable development.[6]

By contrast, patient capital can have more beneficial effects because it tends to be better aligned with country's long-term development goals.[7] Such bilateral lending is an important pillar of the East Asian model of foreign aid, which aims to promote infrastructure development and foreign direct investment as key drivers of longer-term economic growth.[8] It also allows countries to incrementally correct their policy errors without threatening destabilization.[9] Indeed, patient capital tends to incur uncertainty today in hopes of a more substantial return later, which is particularly appealing to those debtors who are frustrated by market-based capital's short-term volatility.[10]

Finally, compared to market-based creditors, China's form of patient capital is often willing to endure emerging market business cycle risk. It signals such risk tolerance through promises of non-intervention in sovereign affairs. In fact, the rising power has avoided onerous policy conditions, or credit being contingent on a country's macroeconomic performance. Whereas market-based creditors often want short-term policy assurances to ensure higher near-term financial returns, Chinese patient capital seeks to promote long-term commercial opportunities by linking its investments to guaranteed contracts for its firms.

What are the policy ramifications of this shift from impatient to patient capital? I suspect that a patient capital approach to global finance allows developing countries to escape budget constraints traditionally

---

[4]Mosley 2003; Datz 2009.
[5]Frieden 2016.
[6]Kaplan 2013; Kaplan and Thomsson 2017.
[7]Kahler 1998.
[8]Stallings 2017.
[9]Kahler 1998.
[10]Armijo 1999; Calvo 1998.

imposed by global capital markets,[11] and international financial institutions.[12] The commodity boom provided such an alternative funding source during the early to mid-2000s, often helping governments increase their budgetary spending.[13] However, in the wake of the global financial crisis and the ensuing commodity correction, governments searched for new financing options to help gain budgetary maneuverability.[14]

I employ cross-national economic and political data to examine the relationship between Chinese financial hemispheric expansion and macroeconomic policy across 15 Latin American countries from 1990-2015. I expect that bilateral state-to-state financing is a form of patient capital that enhances Latin American governments' fiscal policy autonomy, and ultimately, yields higher deficit spending. I also anticipate that the extreme, or populist left is most likely to take advantage of this policy autonomy. I focus on fiscal governance because a government's priorities are reflected in its national budget, just as a firm or household's preferences are conveyed through its balance sheet. Finally, I examine these claims in Latin America, a region that is ideally suited for this analysis because of its considerable variation in exposure to Chinese bilateral financing – about three-fifths of its governments had loans outstanding to China over the last decade.

In order to operationalize Chinese bilateral financing, I employ a unique, novel dataset, dubbed the *China Global Financial Index*. The index characterizes Chinese policy loans by their financing channel (state-to-state vs. market-based) for each national level investment project. To my knowledge, its the first of its kind to classify policy bank loans by their investment channel.

I find that government deficits increase as Chinese state-to-state financing accounts for a larger share of total external public financing (relative to other forms of financing such as capital markets, multilateral loans, or commercial banking). In addition to the general effect, the results also suggest that those governments from the extreme left are most likely to bypass their budgetary constraints when they borrow from China.

These findings offer new insights for studies examining globalization and development, which have found considerable variation in the extent of government intervention in national economies. On one side of these debates, scholars have contended that economic integration,[15] global capital markets,[16] and international

---

[11] Mahon 1996; McNamara 1999; Mosley 2000; 2003; Wibbels 2006; Kaplan 2013.

[12] Thacker 1999; Vreeland 2003; Nelson 2015.

[13] Weyland 2009; Pinto 2010; Murillo, Oliveros, and Vaishnav 2011; Kaplan 2013.

[14] Tax reform is another long-term option for expanding the revenue base, but the electoral calendar often impedes shorter-term reform efforts (Hallerberg and Scartascini 2017).

[15] Cerny 1995; Rudra 2002.

[16] Mahon 1996; McNamara 1999; Mosley 2000, 2003; Wibbels 2006; Brooks, Cunha and Mosley 2014.

financial institutions[17] have led to a retrenchment of Keynesian-style countercylical fiscal policies in developing countries, including budget deficits and social safety nets. In support of this view, scholars find that a variety of factors, including a weak labor movement,[18] party-brand dilution,[19] strong business interests,[20] reform-seeking politicians,[21] centrist economic voters,[22] and increasingly non-economic voters[23] helped facilitate a broad-based acceptance of this neoliberal consensus.[24] Notwithstanding such policy retrenchment, other scholars find that neoliberal reforms have not been uniform. Rather, many countries with import substitution industrialization legacies (ISI) crafted political bargains[25] that preserved supply side economic interventions, including industrial promotion, public employment,[26] labor protection,[27] and social insurance.[28] I engage with this important issue, showing that the emergence of Chinese state-led financing has endowed governments with greater fiscal space compared to market-centric governance.

This study also has significant implications for international political economy scholars examining trade and investment flows from developing-country rising powers, including such topics as the global emergence of national development banks,[29] the rise of China in the world economy,[30] debt and development in non-democracies,[31] and the prospects for China's currency, the renminbi, becoming a major global reserve currency.[32] These studies break new scholarly ground, exploring how the transfer for wealth from developed to developing countries is affecting the global economic architecture. My argument seeks to complement this literature by offering a systematic examination of how China's approach to global finance affects the policy choices of individual debtor countries.

Finally, the analysis also contributes to debates within the broader international relations literature. The 'realist' perspective is deeply suspicious of Chinese motives,[33] perceiving China's Western Hemispheric

---

[17]Vreeland 2003; Nelson 2015.
[18]Roberts 2002.
[19]Lupu 2014.
[20]Thacker 2000; Fairfield 2010.
[21]Corrales 2000.
[22]Baker 2008; Baker and Greene 2011.
[23]Hellwig 2014.
[24]Stokes 2001; Murillo 2002; Weyland 2002; Levitsky 2003; Roberts 2012.
[25]Frieden 1991.
[26]Kurtz and Brooks 2008.
[27]Carnes 2014.
[28]Wibbels and Ahlquist, 2011.
[29]Sierra and Hochstetler 2017.
[30]Wise 2018; Gallagher 2016; Gallagher and Porzecanski 2010; Wise and Quiliconi 2007.
[31]Ballard-Rosa 2016; Ballard-Rosa, Mosley, and Wellhausen 2017.
[32]McDowell and Steinberg 2017; Liao and McDowell 2016; Steinberg 2014.
[33]Mearsheimer 2001.

expansion as part of a geopolitical strategy to mitigate U.S. power.[34] Other scholars see China as a "partial power," investing heavily in global trade and commodities, but lacking global influence.[35] In this regard, many consider China's Latin American presence to be more commercial than geopolitical, offering little challenge to U.S. regional influence.[36] In other words, China primarily hopes to secure new markets for its manufacturing exports and raw material imports.[37] Political stability is central to these goals, so it pursues broad, cross-ideological relationships.[38] My analysis brings a new perspective to this work by employing a systematic comparative analysis of the shifting power balance between the United States and China.

The article unfolds as follows. I begin with the main theoretical contribution, explaining how the emergence of Chinese state-to-state lending has increased national policy discretion relative to traditional market governance models of sovereign borrowing. I then provide quantitative empirical support for this theory using Latin American data. Finally, I close by discussing some key cases and the study's broader implications.

2   Theoretical Framework

The rise of Chinese capital globally coincided with a watershed moment in the history of international markets – the 2008 global financial crisis. After the crisis curtailed U.S. demand, China began investing overseas to create new trade opportunities. China's 2001 WTO entry had long-ago catalyzed its Latin American trade, but the rising power had hoped that regional investment in infrastructure, construction, and heavy extraction industries could meet two important strategic national goals simultaneously: improving its access to raw materials and energy supplies, while securing new export markets to replace those lost to the U.S. recession. Today, China has become the top trade partner for Brazil, Chile, and Peru, and a key capital provider to many Latin American nations that are eager to address longstanding infrastructure deficits.[39]

Over the last decade, Latin America has developed into the second largest destination for China's overseas investment, making the region a "natural extension" for China's flagship economic development program,

---

[34]Lanxin 2008.
[35]Shambaugh 2013.
[36]Roett and Paz 2008; Stallings 2008; Tokatlian 2008.
[37]Kaplan 2006.
[38]Domínguez 2006; Shambaugh 2007.
[39]Myers and Wise 2017; Roett and Paz 2016; and Arnson, Heine and Zaino 2014.

the Belt and Road Initiative (BRI).[40] Chinese policy banks (i.e. Chinese Development Bank, China Export-Import Bank), charged by the government to finance infrastructure and trade, have provided more than $140 billion in Latin American loan commitments,[41] accounting for an average of $12.8 billion (about 5 percent of regional GDP) annually. Over the next decade, China has also pledged to invest an additional $250 billion, which if realized, would push this annual figure above $20 billion (almost 7 percent of regional GDP).

Given the considerable size of these loan commitments, it's important to examine how they affect national economies, particularly in comparison to private sector flows, which were the dominant source of cross-border investment throughout the previous two decades. For example, between 1995 and 2005, a total of $15 billion (13 percent of regional GDP) annually was sourced from the private sector by Latin American governments.

2.1 Patient vs. Impatient Capital

How do these Chinese policy bank loans compare to private sector debt? The majority of private sector debt tends to derive from global bond markets. In fact, more than three-quarters of the private debt above was financed in global capital markets. These market-based financing flows have their advantages, including favorable interest rates amid buoyant credit conditions.[42]

But, the short-term nature of this portfolio investment disproportionately places the burden of risk on debtor countries, which can be particularly arduous during credit downturns. Portfolio investors, many of whom compete in a competitive asset management industry that's known for its short-term performance benchmarks, tend to be restless financiers. Notwithstanding countries' long-term development goals, these investors often sell sovereign assets when they underperform their benchmark quarterly or annual returns. The consequent cross-border capital flight can leave a country cash-starved at is most pressing hour, forcing governments to raise interest rates and pursue austerity (i.e. budget discipline) in hopes of enticing some overseas capital to stay invested in the country. In its most extreme form, capital comes to a "sudden stop," creating a vicious cycle of capital outflows, credit shocks, and austerity that can hamper economic activity.

Patient capital, by contrast, is characterized by a long-term horizon and greater risk tolerance. For example, these financiers typically stay with their investments through good times and bad. They are

---

[40] *Xinhua*, January 20, 2018.
[41] Gallagher 2016; Gallagher and Myers 2016.
[42] Frieden 2016.

willing to incur uncertainty today in hopes of a more substantial return later. Patient capital investors come in all shapes and sizes, ranging from individuals (i.e. parents invest in their children's education) and firms (i.e. venture capitalists invest in innovative ideas), to non-profit institutions (i.e. social entrepreneurs invest in societal value, or social returns) and countries (i.e. state banks investing in technology acquisition for promising firms). Financial systems based on such patient capital tend to yield dramatically different outcomes for financial stability,[43] and national economic policymaking.[44]

During the second half of the 20th century, such patient capital financial systems were a critical factor behind the high investment rates associated with the East Asian development model.[45] In contrast to Western governance systems' emphasis on short-term and arms-length relations to appease corporate boards of directors, these systems featured long-term relationships between financiers, companies, and the state,[46] with development banks in particular investing with social purposes beyond short-term profit-maximization.[47]

Chinese state-owned capital represents the latest manifestation of patient capital in the global financial system. Backed by China's implicit guarantee of their loan portfolios, the country's policy banks are more insulated from debtors' financial distress than market investors, affording them a longer-term perspective.

These state-owned enterprises also often take their cues from the Chinese government's foreign economic strategy, blurring the lines between business and politics. Based on its own successful development experience, China employs its policy banks to help build infrastructure and production facilities in developing countries.[48] These loans are bundled with trade credits and foreign direct investment, with the aim of promoting economic growth. In contrast to the short-term volatility of capital markets, these resources are packaged to promote the local presence of Chinese firms in hopes of stimulating long-term development nationally, and greater integration globally.

In many ways, China's bank finance today is reminiscent of 'tied-aid' historically, where credit lines were often extended to developing countries by Japan and the U.S. through commercial bank loans,[49] bilateral development loans, and supplier credits from export-import banks in exchange for the purchase of goods and

---

[43] Hardie and Maxfield 2013; Hardie, Howarth, Maxfield, and Verdun 2013.
[44] Kaplan 2013; Kaplan 2016.
[45] Wade 2007.
[46] Kahler 1998; Maxfield 1998, Wade 1998.
[47] Wade 2007.
[48] Stallings 2017.
[49] Frieden 1987.

services from the creditor nation.

Beyond bolstering trade ties, however, policy bank finance also seeks to extend the web of regional Chinese contractors, suppliers, and workers. Indeed, China's "go global" strategy, first articulated by President Jiang Zemin in 1998, aims to promote the interests of the Chinese state globally by internationalizing Chinese investment and lending, and securing long-term access to energy and raw materials. During China's recent economic doldrums, it also served as a convenient outlet for the country's construction overcapacity, with almost three-quarters of Chinese loans supporting investment in infrastructure and heavy industries, such as energy and mining.[50]

Beyond these well-choreographed foreign economic strategy goals, Chinese finance also reflects another long-term commitment, the nation's pledge to empower developing countries. Although examining China's political motivations is beyond this paper's scope, its 2016 White Paper on Latin America and the Caribbean[51] talks of "win-win cooperation," "multi-polarization," and "enhancing the representation and voice of developing countries." Similarly, in President Xi Jinping's speech at the seventieth anniversary of the United Nations, he declared:

> "The movement toward a multi-polar world, and the rise of emerging markets and developing countries
>
> have become an irresistible trend of history."[52]

President Xi also repeatedly referenced the importance of the "democratization of international relations" in the columns of the People's Daily in the prelude to his September 2015 U.N. speech.[53] Such statements suggest that China's regional investments are oriented towards far more than the "bottom line." China employs economic cooperation as an instrument of soft power to both bolster its long-term strategic importance in the developing world,[54] and its advocacy for greater equality of representation in global affairs.[55] Indeed, China's global economics and politics are often inextricably linked.[56]

---

[50] Gallagher 2016; Gallagher and Myers 2016.

[51] China's Policy Paper on Latin America and the Caribbean" (Ministry of Foreign Affairs of the People's Republic of China, November 24, 2016), http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1418254.shtml.

[52] Xi Jinping, Xi Jinping zai Lianheguo Chengwei 70 Zhounian Xilie Fenghui Shang de Jianghua [Xi Jinping's Speech for the United Nations' 70th Anniversary Summit Meeting (Beijing: Renmin Chubanshe, 2015).

[53] Xi Jinping, "Gongjian Huoban Guanxi Gongchuang Meihao Weilai," [Building Common Partnership, Creating a Beautiful Common Future] Renmin Ribao, July 10, 2015, 3rd edition.

[54] Schweller and Pu, 2011; Ferchen 2013.

[55] Shambaugh 2013.

[56] Flores-Macías and Kreps 2013.

2.2   The Policy Consequence of the Shift to Patient Capital

What are the policy implications of China's patient approach to financing developing countries? The globalization scholarship suggests that the structure of capital is essential to determining capital's constraint on national policymaking. For example, within the seminal debate between convergence and divergence thinkers, both schools of thought agree that mobile capital's capital exit threat pressures national governments to curtail deficit spending. They differ on the question of whether states have the capacity to countervail some of these pressures. Convergence thinkers anticipate a 'race to the bottom' where states have little power to resist capital's interests, while divergence thinkers are more optimistic about states' capacity, expecting that governments could intervene economically to offset globalization's dislocations.[57]

Scholars find that convergence pressures are often most acute for developing countries that have a higher capital dependence and less-developed institutions than many developed countries.[58] This capital-dependency makes them sensitive to market metrics, many of which emphasize short-term policy benchmarks such as budget discipline and inflation control in lieu of other longer-term oriented economic policies.[59]

Compelling such fiscal austerity might in part reflects a U.S. ideological agenda, but it also seeks to protect creditor interests by bolstering state finances, and hence, the chances of debt repayment.[60] However, it gives debtor governments less budgetary room to maneuver because the failure to meet market metrics can spur capital outflows and credit shocks.

Compared to mercurial nature of private capital, China's policy banks do not impose stringent borrower conditionality. They operate under an official doctrine of nonintervention in domestic affairs, as stipulated in the country's Five Principles of Peaceful Coexistence.[61] For example, China's State-owned Assets Supervision and Administration Commission (SASAC) considers "respect for the laws and policies of the country being invested in and respect for local customs" as primary principles in its foreign investment guidelines.

If not through policy conditionality, how does China mitigate the potential for higher-than-expected credit risk? Government lending is secured either through commodity-backed loans, which are collateral-

---

[57]For a full discussion, see McNamara 1998 and Mosley 2000.
[58]Rudra 2002; 2008; Bunte 2016.
[59]Mosley 2000; Mosley 2003; Mosley, Wibbels, and Paniagua 2017.
[60]Thacker 1999; Vreeland 2003.
[61]China's Initiation of the Five Principles of Peaceful Co-Existence, Ministry of Foreign Affairs, November 17, 2000.

ized by future commodity deliveries, or by guaranteed contracts with Chinese state-owned enterprises. By reducing their exposure to default risk with commercial ties rather than policy conditions, these banks can simultaneously promote the interests of the Chinese state globally.

For debtor countries, the longer-term financing horizon may be conducive to promoting local development because it affords their governments more time to overcome policy missteps, political uncertainty, and economic volatility. At the same time, however, the steep cost of capital, extensive Chinese foreign content, and the lack of governance standards could create long-run costs for local firms, workers, and environment.

Notwithstanding the question of longer-term development, I expect that the influx of Chinese patient capital should yield greater policy divergence in Latin America. Without the threat of destabilizing capital outflows, developing country governments should have more fiscal space to intervene in their economies.

In addition to this general effect, I also expect to observe a conditional pattern where fiscal deficits increase most acutely under extreme left partisans. The prospect of greater policy latitude should be most appealing to those radical leftist governments that have difficulty raising funds in global markets. The Latin American left has often aimed to use public authority to redistribute wealth and reduce socioeconomic inequalities.[62] The moderate left has often met these goals within a balanced budget framework. However, the radical left[63] has been a proponent of greater government intervention, because the market has often constrained a considerable part of its political agenda. To the extent that Chinese finance allows more extreme left partisans escape such hard budget constraints, we should be more likely to observe greater deficit spending.

3   Empirical Tests

To evaluate these theoretical priors systematically, I translate them into a testable hypothesis:

H₁: An increase in Chinese bilateral lending as a share of total external public financing (relative to other forms of financing such as capital markets, multilateral loans, or commercial banking) will lead to a deterioration in fiscal balances, or higher budget deficits. This general pattern should hold across the political spectrum, but is most pronounced under extreme left regimes.

---

[62]Levitsky and Roberts 2011; Luna and Kaltwasser 2014.

[63]Weyland, Madrid, and Hunter 2010.

3.1 Model Specification

Specifically, I operationalize this hypothesis with the following dynamic panel model specification, which has lags of both the dependent and independent variables. The lagged dependent variable helps account for the influence of past economic performance on present conditions, specifically potential long fiscal policy lags. While fiscal policy may rapidly affect the economy through automatic stabilizers (i.e government spending increases because of recession-driven government benefits like unemployment insurance), its effect can also be slow because of implementation delays due to the political process.[64]

Lagged independent variables were also used, based on the assumption that many of the economic variables included in the model do not have an instantaneous effect on the outcome variable, and may be distributed across more than one time period.[65] However, I did include contemporaneous values for those international economic variables – including global growth and commodities – that are primarily expected to affect fiscal and economic outcomes within the current year because of high global interdependence (see control variables discussion).

$$Fisc_{it} = \alpha + \beta_1 Bilateral_{it} + \beta_2 X_{it} + \beta_3 X_{it-1} + \gamma_1 Fisc_{it-1} + \eta_i + \varepsilon_{it}$$

where $Fisc_{it}$ =fiscal balance; where $Bilateral_{it}$ = the share fo bilateral, state to state lending relative to total external public debt. The index i =country and t =year. X_{it} = vector of control variables; X_{it-1} = lagged independent variables; and $Fisc_{it-1}$ = fiscal balance (one year lag). The term η_i = dummy for each country, intended to capture unobserved country effects, while ε_{it} = error term.

Notably, I vary the lag structure of this general model within the statistical analysis, imposing the constraint, $\gamma_1 = 0$, to remove the lagged dependent variable and mitigate concerns about serial correlation leading to biased results.[66]

To test the hypotheses, I focus on the coefficients on $Bilateral_{it}$ (state-to-state financing). A negative coefficient would provide support for the hypothesis that state-to-state financing leads to a deterioration in fiscal balances (i.e. widens budget deficits, or narrows budget surpluses).

---

[64]Mankiw 2012.
[65]Keele and Kelly 2006 and De Boef and Keele 2008.
[66]Achen 2001; also see Keele and Kelly 2006.

3.2 Methodology

The findings are presented using panel corrected standard errors, fixed effects and generalized methods of moments (GMM) estimators. The empirical results are consistent across all the estimation procedures, lending support to the primary hypothesis.

A potential problem with the fixed effects specification is the lagged dependent variable will lead to biased parameter estimates.[67] The problem is thought to be especially severe in micro-panel data where the T is quite small. Therefore, I initially employ a model without the lagged dependent variable, first using panel corrected standard errors and then an AR(1) fixed effects specification to address potential serial correlation.

I then conduct a robustness check, adding the lagged dependent variable, and using the GMM estimator introduced by Arellano and Bond.[68] This estimation strategy uses first differences to transform the regressors and remove the fixed country effect. It then instruments the differenced variables that are not strictly exogenous with all their available lags in levels in order to eliminate the potential source of bias. Finally, the use of first-differences also corrects for autocorrelation by instrumenting the first-differenced lagged dependent variable with its past levels.[69]

3.3 Data

This section evaluates the hypothesis using a panel of data covering 15 Latin American countries from 1990-2015. Employing the dataset, we can observe to what extent patient capital endows countries with greater room to maneuver. To assess policy flexibility, I focus on fiscal governance not only because of its centrality to market governance, but also because of its importance in understanding government objectives. I thus employ the primary fiscal balance as a percentage of GDP (Fiscal balance) as the dependent variable. I use the primary fiscal balance (net of interest payments on public debt) rather than the general government balance (inclusive of interest payments) because it is the more appropriate measure of the government's fiscal policy stance, particularly in highly indebted countries.

---

[67]Nickell 1981.
[68]Wawro 2002; Roodman 2009.
[69]Mileva 2007.

3.3.1 Independent Variable: Chinese State-to-State Lending (Patient Capital)

To test these theoretical priors, I construct a variable, $Bilateral_{it}$, that measures a government's total Chinese state-to-state loans as a share of its total external financing, relative to other forms of financing such as capital markets, multilateral loans, or commercial banking. I expect that bilateral loans are more stable during distress, helping mitigate funding shocks (i.e. higher borrowing costs stemming from foreign investors' capital withdrawal during economic and financial downturns) that constrain government budgets. Patient capital should thus make it easier for countries to conduct countercyclical macro-economic policies.

I construct the Chinese bilateral loan data from a new, originally designed dataset called the *Chinese Global Finance Index*, which characterizes the financing channel (state-to-state vs. market-based) for Chinese policy bank loans by national investment project. In other words, when Chinese financing takes the form of state-to-state lending, the funds directly enter government coffers, enabling incumbent politicians to increase their spending on their political agendas. By contrast, when these loans are instead booked to a corporate entity in the marketplace (either a private firm or a separately managed state-owned enterprise) through government concessions, the central government does not benefit from the loan directly.[70] Consequently, they do not secure new budgetary financing, which creates considerable national variation in China's regional underwriting of public financing. I exploit this variation in sovereign financing type to test whether Chinese state-to-state financing enhances Latin America's fiscal policy autonomy and yields higher deficit spending.

I gathered this data using a variety of sources, including primary sources at Latin American finance and planning ministries during my field research,[71] and official websites of central banks and ministries of finance. I reinforce these individual efforts by also cross-checking them across other sources, including US SEC filings of foreign governments, investment bank reports, AidData, RED ALC-China, and the Inter-American Dialogue's China-Latin American Database.

While the aforementioned sources contain basic descriptive project characteristics (i.e. main investors,

---

[70]Similar to this study, the foreign aid literature has also found that policy discretion is conditional on whether funds are allocated through the government or non-state actors (Dietrich, 2013; Winters, 2010).

[71]I conducted field research in six different Latin American countries between 2013-2017, including the region's primary debtors to China (Argentina, Brazil, Ecuador, and Venezuela).

primary contractors, type of project, and expected tenure), this dataset is the first one of its kind to code each individual loan's financing channel (i.e. state-to-state vs. market based). The dataset is also unique in that its calculations are based on the amount actually disbursed to countries, and not on initial project announcements. Finally, this new dataset uses *net* rather than *gross* disbursements, meaning that the loan data is adjusted annually to account for debtor repayment and creditor roll-overs (to avoid double-counting of debt obligations). While gross disbursement numbers are often discussed in the popular press, the net figures are vital to accurately examining the impact of lending on public finances.

Finally, in additional robustness checks, I also employ bilateral loan data from external debt statistics by the BIS, IMF, OECD, and the World Bank that reflect commitments that are owed by a sovereign nation to foreigners, or non-residents. Given the emergence of other regional sovereign creditors recently (i.e. Russia), examining such data will help us understand if these patterns might hold more generally for other sovereign creditors beyond China.

3.3.2   Independent Variable: Partisanship

In order to test for whether or not Chinese bilateral loans have a conditional partisan effect on national budget deficits, I employ the World Bank's Database of Political Institutions. It offers a measure that helps account for partisan behavior in Latin America's complex political spectrum, where political parties have either shifted their ideological priorities or diluted their partisan brands over time. It codes party orientation with respect to economic policy along a right-left spectrum from 0 to 3.[72] Employing this coding, I design the binary variable, $LeftPartisanship_{it}$, to test if left-leaning politicians (compared to centrist and right-leaning politicians) are more likely to pursue higher budget deficits when tapping Chinese bilateral loans.

$$LeftPartisanship_{it} = \left\{ \begin{array}{c} \text{1 if government is classified as left leaning.} \\ \text{0 otherwise.} \end{array} \right\}$$

---

[72]Parties defined as conservative, Christian democratic, or right-wing have a value of 1. Parties defined as centrist are a 2. Parties defined as communist, socialist, social democratic, or leftist have a value of 3. Otherwise, the variable is 0.

In additional robustness checks, I employ a different measure of left partisanship that instead ranks ideological scores along a continuum. Based on Baker and Greene's (2011) measure of the ideological leanings of electorates since 1993,[73] I created a variable called $LeftIdeology_{it}$. Compared to the binary variable above, it preserves fine-grained distinctions among parties along the entire ideological spectrum. It will help examine how Chinese financing affects fiscal policymaking under more nuanced shifts in government priorities.

3.3.3   Control Variables

I control for a variety of global economic factors, domestic economic variables, and institutional factors that may affect national fiscal balances. First, I control for global growth (Global growth), given that the sample includes many small open economies. Because many Latin American countries are dependent on primary commodity exports, I also include a global commodities index (Global Commodities) to account for international commodity volatility. I expect global fluctuations in growth and commodities to show relative fast dynamics, influencing domestic budget balances in the current year. I also include a lagged measure of overall external indebtedness (External debt) to control for its effect on fiscal policy and the economy.

I also employ several control variables that are standard in fiscal policy regressions in the economics literature. They are an output gap (Domestic output gap) and an unemployment rate (Unemployment) – both lagged by one year – to control for a country's position in its economic cycle. By comparison, inflation (Inflation) is not lagged to account for a potential Olivera-Tanzi effect, where high inflation contemporaneously erodes tax receipts, and hence, budgetary accounts in developing countries. In addition, I use a measure of constraints on executive power (Executive constraints) based on the assumption that budgetary cycles are less common when presidents confront greater checks and balances.

Finally, to account for institutional factors that may affect budget balances, I add several control variables, including measures of IMF participation (IMF), partisanship (Left governments), legal central bank autonomy (Central bank independence), interest rates (Interest rates) and the exchange rate regime (Exchange rate). The central bank autonomy measure was not included in the regression results because it assigns numerical values to countries that do not vary over time, making it indistinguishable from the coun-

---

[73]Ideological scores, based on a combination of parties' ideologies and vote shares, are calculated on a 20-point scale, moving from extreme left (1) to extreme right (20).

try dummies already incorporated in the model. Additionally, I employed lagged dependent variables to control for past budgetary performance, and the possibility of slow implementation of fiscal policy.

3.4   The Effect of State-to-State Lending on Fiscal Balances

Does an increased prevalence of bilateral, state-to-state financing give national governments greater degrees of policy flexibility? Characterized by less market scrutiny of budgetary accounts, I anticipate that an influx of such patient capital leads to high budget deficits.

In a series of basic regression models, I first examine the unconditional effects of the independent variables on budget balances, employing panel corrected standard errors (PCSE). [74] I find that an increase in bilateral loans as a share of total external financing endows governments with more room to maneuver as exhibited by higher primary fiscal deficits (model 1 in Table1). In other words, a 10 percentage point increase in bilateral lending as a share of external public debt is associated with government budget deficits shrinking by 0.82 percentage point of GDP.

---

[74]Beck and Katz, 1995.

Table 1: The Effect of State-to-State Lending on Fiscal Policy Flexibility

	(1) PCSE	(2) FE	(3) GMM	(4) PCSE	(5) PCSE	(6) PSCE	(7) GMM
Chinese StS / Debt	-0.082***	-0.037**	-0.028***	-0.092***			
	(0.013)	(0.018)	(0.009)	(0.016)			
Bilateral Loans / Debt					-0.031**		
					(0.016)		
Chinese StS / GDP						-0.425***	-0.133***
						(0.076)	(0.039)
Global Growth	0.249**	0.218***	0.326***	0.290***	0.300***	0.296***	0.351***
	(0.106)	(0.060)	(0.091)	(0.103)	(0.111)	(0.105)	(0.089)
Output Gap	0.057**	0.025	0.042	0.036	0.032	0.030	0.030
	(0.025)	(0.024)	(0.029)	(0.027)	(0.029)	(0.027)	(0.024)
Global Commodities Index	0.001	-0.002	0.005	-0.007	-0.011	-0.007	0.002
	(0.009)	(0.004)	(0.007)	(0.009)	(0.010)	(0.010)	(0.007)
Inflation (log)	0.350***	0.659***	0.618***	0.328***	0.071	0.354***	0.732***
	(0.112)	(0.109)	(0.173)	(0.114)	(0.104)	(0.114)	(0.160)
External Public Debt (t-1)	0.003*	-0.000	-0.016	0.004***	-0.001	0.003**	-0.012
	(0.001)	(0.002)	(0.012)	(0.001)	(0.002)	(0.001)	(0.012)
Unemployment (t-1)	0.031	0.070*	0.041	0.046	-0.004	0.050*	0.035
	(0.030)	(0.041)	(0.036)	(0.030)	(0.033)	(0.030)	(0.037)
Interest Rate (t-1)	0.000	0.000	-0.000***	0.000	-0.000**	0.000	-0.000***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Executive Constraints				-1.044	-0.981	-1.013	-0.828
				(0.647)	(0.676)	(0.648)	(0.574)
Left Partisanship				1.313***	1.442***	1.228***	0.740*
				(0.216)	(0.229)	(0.204)	(0.382)
IMF Program				-0.351	0.045	-0.359	-0.176
				(0.239)	(0.256)	(0.236)	(0.164)
Primary Fiscal Balance (t-1)			0.662***				0.614***
			(0.076)				(0.074)
Observations	329	329	283	310	350	310	265
R^2	0.23			0.31	0.25	0.31	

Standard errors in parentheses

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

Results for the control variables are also consistent with expectations. The coefficient for global growth is positive and statistically significant, suggesting that improved budget balances tend to coincide with expanding economic activity (model 1 in Table 1). The output gap is also positively associated with the fiscal balance, meaning that budget deficits (surpluses) tend to narrow (increase) when the economy is above its trend growth rate. Notably, the coefficient for left partisanship has a statistically significant and positive relationship with fiscal balances. While left governments are typically expected to have a proclivity to spend, this finding supports the notion that they are more likely to adhere to a deficit-constraint in a capital-dependent region like Latin America where left governments must often signal their good economic governance to global creditors.

In model 2, I instead use an AR(1) fixed effects specification to address potential serial correlation. Notably, the results maintain their precision. In model 3, I then repeat the statistical tests just described, but add a lagged dependent variable. To mitigate concerns about both (Nickell) bias resulting from the lagged dependent variable, and the possibility of reverse causality in the independent variables, I employ the Arellano-Bond GMM first-difference estimator.

Overall, the GMM results support the governing hypothesis that Chinese bilateral financing tends to be associated with higher budget deficits. Additionally, the coefficient for the lagged dependent variable, primary fiscal balance (t-1), has a positive and statistically significant relationship, implying that a history of prudent fiscal governance makes budget discipline more likely today. However, the precision of the fiscal policy lag diminishes beyond one-year. Notably, the Arellano-Bond test for the GMM-estimators presents no significant evidence of serial correlation in the first-differenced errors at the second order (p = 0.501). The Sargan test also suggests that the model has the correct specification and that the overidentifying restrictions are valid (p = 0.267).

In model 4, I inserted several additional control variables – including executive constraints, left partisanship, and the existence of an IMF program – into the original models to account for the potential influence of institutional factors on government budgets. None of these additional controls significantly changed the size, direction, or statistical significance of the key results (see Table 1).

In a series of further robustness checks, I employ bilateral loan data – jointly collected by the BIS,

IMF, OECD, and the World Bank – to examine whether these patterns hold more broadly for state-to-state creditors beyond China. The coefficient on bilateral loans remains negative and statistically significant, but is less precise and smaller in magnitude (model 5 in Table 1). While this pattern suggests that other forms of patient capital (i.e. bilateral lending from other nations) may also enhance policy flexibility, bilateral Chinese lending's lack of policy conditionality appears to more readily promote budgetary largesse.

Might low indebtedness instead be the main driver of greater policy maneuverability? As discussed earlier, I have included a control for external indebtedness in the regression analysis. However, to ensure that countries with more sustainable debt levels are not driving the results, I re-estimated the main independent variable – Chinese state-to-state lending – to further establish the results are driven by the structure of the debt, and not the overall size of the debt. In these models, I normalize Chinese bilateral loans by GDP instead of total external financing needs. The re-estimated models confirm the earlier results showing that Chinese bilateral loans have a liberating effect on budgetary accounts (see model 6 in Table 1). The results also remain robust when using the lagged dependent variable model with the Arellano-Bond GMM estimator (model 7).

3.5 The Conditional Effect of Partisanship on Fiscal Policy Stances

Are left governments more likely than their centrist and right counterparts to use Chinese financing to bypass the market's historic emphasis on budget discipline?

In the conditional regression models (see models 1-4 in Table 2), let us first examine the relationship between Chinese bilateral lending and fiscal policy. Chinese bilateral lending has a strong and statistically significant effect on budget deficits, once again lending support to our primary hypothesis. Note that these results for Chinese state-to-state lending hold when normalizing by both GDP and external financing (models 1 and 3), suggesting that the findings are driven by the structure of the debt, rather than the size of the external debt or the economy. To further check their robustness, I also inserted several additional control variables into models 2 and 4, including the exchange rate regime and institutional constraints on executive power, to account for the potential influence of institutional factors on national budgets. None of these additional controls significantly change the size, direction, or statistical significance of the key results.

20

Does this estimated impact of Chinese bilateral lending differ based on the partisanship of the government? Figure 2 shows the marginal effect of these conditional models. When countries have little or no exposure to Chinese state-to-state financing, left partisanship has a positive and statistically significant effect on budget balances. Fearing the threat of capital exit, left governments often adhere to market calls for budget discipline. They tend to increase budget deficits by about 1.5 percentage points of GDP (Table 2).

Table 2: The Effect of State-to-State Lending and Partisanship on Fiscal Policy Flexibility

	(1) PCSE	(2) PCSE	(3) PCSE	(4) PCSE	(5) PCSE	(6) PCSE	(7) PCSE
Chinese StS / Debt	-0.081*** (0.012)	-0.083*** (0.014)			-0.548*** (0.117)	-0.467*** (0.129)	
Chinese StS / GDP			-0.369*** (0.078)	-0.307*** (0.074)			-1.692** (0.754)
Left Partisanship	1.612*** (0.204)	1.604*** (0.214)	1.259*** (0.200)	1.386*** (0.194)			
StS Loans * Left Partisanship	-0.194** (0.094)	-0.187** (0.094)	-0.290** (0.130)	-0.432*** (0.118)			
Left Ideology					0.130*** (0.023)	0.137*** (0.024)	0.058** (0.023)
StS Loans * Left Ideology					0.025*** (0.007)	0.020** (0.008)	0.088** (0.045)
Global Growth	0.354*** (0.105)	0.356*** (0.101)	0.341*** (0.101)	0.355*** (0.100)	0.323*** (0.104)	0.338*** (0.099)	0.394*** (0.055)
Output Gap (t-1)	0.035 (0.023)	0.038* (0.023)	0.027 (0.026)	0.049* (0.025)	0.043* (0.023)	0.048** (0.022)	-0.003 (0.020)
Global Commodities Index	0.001 (0.009)	0.001 (0.009)	0.002 (0.009)	0.001 (0.009)	0.002 (0.009)	0.001 (0.009)	-0.001 (0.005)
Inflation (log)	0.271** (0.119)	0.281** (0.129)	0.361*** (0.107)	0.332*** (0.122)	0.218* (0.126)	0.154 (0.141)	0.221** (0.088)
External Public Debt (t-1)	0.005*** (0.001)	0.004*** (0.001)	0.004*** (0.001)	0.002 (0.001)	0.004*** (0.001)	0.005*** (0.001)	0.005*** (0.002)
Interest Rate (t-1)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000** (0.000)	0.000 (0.000)	0.000 (0.000)	-0.000 (0.000)
Executive Constraints		-0.909 (0.702)		-1.059* (0.620)		-1.073 (0.734)	0.070 (0.523)
Exchange Rate Regime		-0.022 (0.089)		0.028 (0.113)		0.178* (0.106)	0.123 (0.102)
IMF Program							0.010 (0.172)
Primary Fiscal Balance (t-1)							0.582*** (0.050)
Observations	341	341	363	361	341	341	341
R^2	0.31	0.31	0.29	0.25	0.27	0.28	0.55

Standard errors in parentheses
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Notably, however, as Chinese bilateral financing accounts for a growing share of GDP, budget balances tend to deteriorate (see Figure 2). For example, when Chinese bilateral financing amounts to a mere 1 percentage points of GDP, left governments tend to increase budget deficits by about 1 percent of GDP compared to their centrist and right-wing counterparts. With greater Chinese bilateral indebtedness, however, left governments become more likely to circumvent their budgetary constraints. For countries where Chinese loans account for 5 percentage points of GDP, they oversee average budget deficits that are about 1 percentage point of GDP higher than other partisan governments.

**Figure 2: Marginal Effect of Partisanship
on Latin American Budget Balances**

Source: Model 4 in Table 2
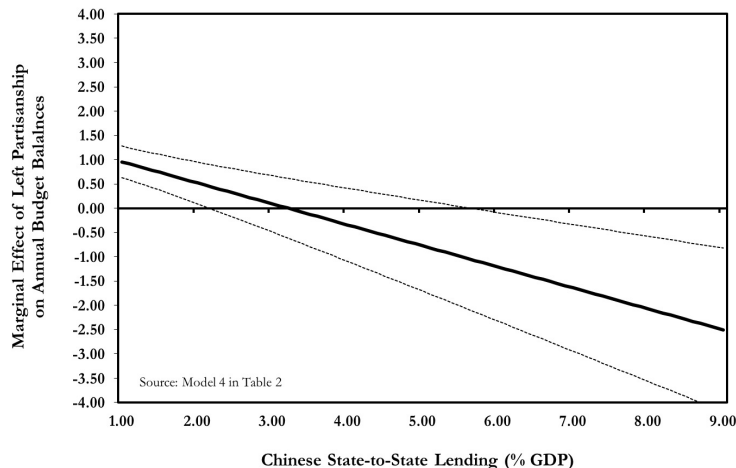
For instance, Bolivia provides an example of a left government that did not borrow from China to get additional fiscal space. President Morales, who entered office as part of a popular indigenous movement seeking greater social rights, had used commodity windfalls to boost state redistribution and social spending.[75] During the 2008-2009 global commodity correction, however, falling hydrocarbon revenues (which account for almost half of total government revenues) depleted its fiscal resources. With Chinese bilateral loans accounted for a modest 0.4 percentage points of GDP, the Bolivia government could not borrow to gain more fiscal flexibility. Instead, it had to cut expenditures to maintain a budget surplus of 1.4 percent of GDP in 2010.[76] Such austerity was aimed at placating its external creditors given that the IMF and private

---

[75]Levitsky and Roberts, 2011.
[76]CEPALSTAT Database, 2017.

borrowers accounted for more than four-fifths of its external financing.

The regression estimates above imply if the Bolivia government had increased its Chinese loans outstanding to Ecuador's 2010 level (about 5 percentage points of GDP), the additional bilateral borrowing could have allowed for as much as 1 percentage point of GDP in new fiscal stimulus.

But, to what extent might the relationship between Chinese financing and left partisanship simply be driven by the most extreme regimes? Perhaps, most politicians across the political spectrum are equally likely to increase budget deficits when borrowing from Chinese creditors.

In order to account for the influence of the most radical left regimes, I split the sample according to Levitsky and Robert's (2011) classification of leftist populist regimes,[77] or those governments with concentrated power in the hands of a personalistic politician seeking to remedy social and economic inequalities.[78] After splitting the sample, I find that the coefficient for the interaction between left partisanship and Chinese bilateral financing remains negative ($\beta = 0.341$) and statistically significant ($p < 0.05$) for the populist left, but loses it precision for the more moderate cases. In other words, extreme left partisans appear to increase their budgetary discretion most acutely when borrowing from China.

In a final robustness check, I use another more nuanced measure of left partisanship to examine the extent to which it might temper the partisan effect of Chinese financing. Employing Baker and Greene's (2011) proxy for incumbent ideology (see control discussion above), I alter the measure of partisanship to account for more gradual shifts in ideological leanings across a continuum. The unconditional effects of Chinese bilateral loans remain negative and statistically significant, lending further support to the primary hypothesis that Chinese state-to-state financing provides greater fiscal space to governments, helping them increase their budget deficits (see models 5-7 in Table 2).

However, when using the more fine-grained ideological measure for the conditional model, partisanship has very little substantive effect. The coefficient for the interaction between Chinese bilateral loans and left ideology is statistically significant, but its magnitude is almost negligible (models 5-7). As governments become incrementally more leftist across the ideological spectrum (ranging from 1 to 20), there tends to be

---

[77]These regimes include Argentina (2008-2015), Ecuador (2007-2015), Nicaragua (2007-2015), and Venezuela (1999-2015).

[78]I initially did not include Bolivia (2006-2015) amongst the most radical regimes, given its links to organized, grass-roots social movements (see Levitsky and Roberts 2011), but later added the country in additional robustness checks to account for Morales' ongoing personalistic appeal (Weyland, Madrid, and Hunter 2010) which did not markedly change the results.

little difference among similar partisans. In other words, the marginal effect of Chinese state-to-state loans tends to be the same for governments near each other in the political spectrum. Compared to the binary results, the smaller partisan differences likely reflect the more subtle distinctions used by Baker and Greene (2011) for parties across the ideological spectrum. It also further suggests that the extreme, or populist left may capitalize most strongly on the lack of policy conditionality associated with Chinese financing.

4   Discussion

To further examine the extent to which Chinese credit affects budgetary balances, I briefly explore some of the dataset's cases in more detail below. In line with the statistical findings, I expect to observe a general effect that Chinese indebtedness leads to greater fiscal largesse across the political spectrum, but also a conditional pattern where it occurs most acutely among extreme left partisans.

Let us momentarily journey to five Latin American countries: Bolivia, Costa Rica, Ecuador, Peru, and Venezuela. They are high middle income countries that are located in a similar geographic region (within 20 degrees of latitude from one another), yet maximize the variation in the main independent variables of interest:[79] Chinese indebtedness. I examine their relationship to budgetary stances in the five years before and after the 2008 global financial crisis, when China emerged as a major regional creditor (see Figure 3).

Before proceeding with the analysis, let us first examine a common alternative explanation for Latin America's fiscal deterioration following the global financial crisis: the commodity downturn. While the statistical findings above were robust to controls for commodity prices, I briefly elaborate on why the commodity downturn is not a sufficient explanation for deteriorating budget balances.

If it were a sufficient condition, we would expect that falling commodity revenues would have led to weakening of budget balances across all five Latin American countries. However, in the five years following the crisis, Bolivia and Peru maintained consistent budget surpluses that averaged more than 1 percent of GDP. By comparison, Costa Rica, Ecuador, and Venezuela's budgetary accounts moved into the red post-crisis, with sustained deficits throughout the period (Figure 3).

---

[79]King et. al. 1994.

Figure 3: Chinese Bilateral Credit and National Budgetary Stances (2004-2014)
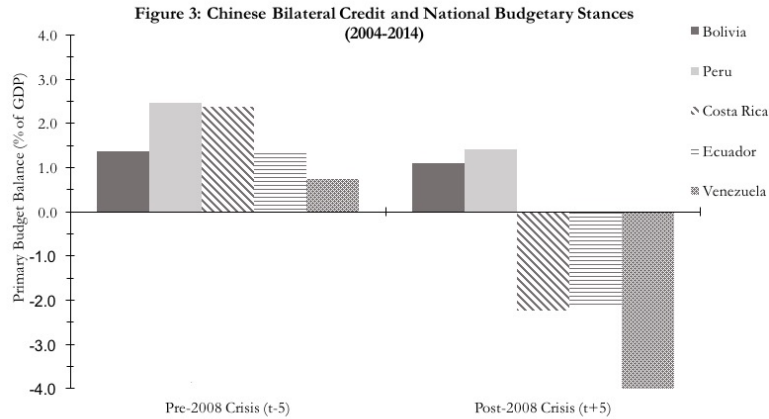
These patterns are particularly surprising because there does not appear to be any direct relationship between commodity volatility and fiscal performance. For example, Bolivia should have been one of the countries that was most susceptible to a revenue shock, given that its pre-crisis, non-tax commodity revenues averaged 11 percent of GDP compared to a regional average of 3.9 percent of GDP. Yet, its government maintained a post-crisis primary budget surplus. At the same time, Costa Rica should have been fairly insulated from post-crisis commodity volatility, with pre-crisis non-tax revenues averaging a paltry 0.25 percent of GDP. Yet, it's government saw its budgetary accounts swing from surplus to heavy deficit.

If commodity volatility does not sufficiently explain changes in fiscal policy, to what extent do Chinese bilateral loans account for the divergence in fiscal performance? In line with my earlier statistical findings, I expect to observe that Chinese bilateral credit is associated with wider budget deficits generally, but that this pattern is most pronounced among the extreme, or populist left.

To examine the general effect of Chinese credit enhancing fiscal latitude, we first turn to Costa Rica. If my theoretical priors are correct, governments from across the political spectrum should tend to increase budget deficits when they gain direct access to sizable amounts of Chinese financing. In Costa Rica, Óscar Arias' centrist government tapped Chinese financing during the global financial crisis to help the country increase its fiscal flexiblity. Without such financing, Costa Rica would have had considerably more difficulty covering its countercyclical spending, as well as its own state bank recapitilization following the crisis.

For example, Peru shared several important characteristics with Costa Rica at the time of the crisis,

including a centrist government[80] and a strong reliance on private sector external financing sources.[81] However, its government did not receive Chinese credit, leaving them with less room to maneuver. The Alan Garcia administration increased its public investment to mitigate the effects of the global crisis and falling mineral prices. However, in contrast to Costa Rica, the Peruvian government maintained primary budget surpluses through the post-crisis period (see Figure 3), in part to sustain its strong external credit position.

Costa Rica had first turned to China in 2008 to help navigate its economic distress. China opened the spigots of its global financing to Costa Rica, after the Arias' government had officially established relations with the People's Republic of China (PRC). Notwithstanding its historical recognition of Taiwan, President Arias considered his diplomatic about-face a 'natural evolution' in light of the important economic development opportunities offered by China.[82] In return, the Costa Rican government immediately received its choice of public financing projects (a $100 million soccer stadium), and $300 million of Costa Rican bond purchases. The bond financing alone amounted to 1 percent of the country's GDP.

Historically, Costa Rica had raised almost two-thirds of its external financing from private sector creditors, but was having a difficult time issuing bonds amid the 2008 global credit crunch. Facing financial turmoil, sharp currency depreciation, and capital outflows, economic officials fretted that the global downturn could destabilize Costa Rica, particularly its U.S. dependent, high-tech manufacturing sector.

The influx of new financing from China helped fund rising government expenditures on social safety nets and public infrastructure that were intended to offset the effects of the downturn. Notably, new 2008 fiscal outlays on these expenditures were just over 1 percent of GDP, equivalent to China's total bond purchases. Other Western investors had been retreating from Costa Rica amid the crisis, propelling the country's foreign bond prices to historical lows and raising the government's funding costs. In contrast to such volatility, China's patient capital provided Costa Rica with more budgetary room to maneuver.

Since the crisis, China and Costa Rican have continued to discuss their 11 state-to-state cooperation agreements, which were also signed after the two countries established diplomatic relations in 2007. However, many of these infrastructure investment projects have been slow to come to fruition, particularly amid

---

[80]Despite often characterized as a radical leftist during his first presidency, Alan Garcia was a more moderate politician during his second presidency (2006-2011), classified as a centrist politician within Baker and Greene's (2011) proxy for incumbent ideology.

[81]Nearly one-half of Peru's external funding came from the private sector during the prelude to the global financial crisis.

[82]DeHart 2012.

local concerns about their environmental sustainability. Nevertheless, the spigots of Chinese financing have reopened in 2017, following Costa Rica's Congressional approval of a major highway infrastructure project, known as Ruta 32. The government will acquire a $465 million loan from China (about 1 percent of 2016 GDP) to help build the 107 kilometer highway project, which will free up more budgetary resources to spend on other domestic priorities.

I expect this pattern of enhanced fiscal flexibility to be most pronounced when countries are governed by the extreme left. To explore such a possibility, let us examine three country cases where such left governments have varied exposure to Chinese credit. Bolivia, Ecuador, and Venezuela have often been grouped under the same leftist populist banner, but compared to its Andean neighbors, the Bolivian government has relatively little access to Chinese bilateral credit. If my theoretical priors are correct, Ecuador and Venezuela should have much greater fiscal latitude compared to the Bolivian government.

Until quite recently, Bolivia had not been a major debtor to China. For example, in the five years following the global financial crisis, Chinese bilateral loans accounted for less than one percentage point of GDP. By comparison, this tally was dwarfed by China's biggest debtors in the region; Ecuador and Venezuela's debt to China averaged 4.5 and 11.7 percent of GDP respectively over the same period. While the presidents governing all three countries (Hugo Chavez, Rafael Correa, and Evo Morales) were part of the same leftist tide that swept through Latin America during the mid 2000s, they parted ways fiscally with the rise of Chinese credit.

Whereas Bolivia remained fiscally frugal, Ecuador and Venezuela oversaw some of the region's largest post-crisis deficits. They escaped fiscal austerity in part because of Chinese unconditional loans. Ecuador and Venezuela moved from lofty budget surpluses of 1.4 and 1.0 percent of GDP in the five years before the crisis to sizable deficits averaging -2.1 and -4.1 percent of GDP in the five years after the crisis.

By contrast, without having much access to Chinese unconditional financing, Bolivia's fiscal accounts barely budged, averaging 1.3 and 1.1 percent of GDP in the five years before and after the crisis respectively (see Figure 3). The sustained fiscal rectitude is surprising given the political success President Evo Morales earned by condemning neoliberalism. Moreover, Morales' party, Movimiento al Socialismo (MAS), has a

substantial left-of-center support base,[83] incentivizing using fiscal policy for greater redistribution. However, its reliance on austerity-linked external credit limited the government's fiscal space, particularly during periods of global commodity volatility. Compared to its regional peers, the delayed entry of Chinese financing left Bolivia with less policy room to maneuver.

In summary, Chinese financing appears to help governments generally increase their fiscal maneuverability. While the conditional partisanship pattern holds among the most extreme left regimes, such as Ecuador and Venezuela, the relationship between Chinese credit and deficit spending is not contingent on partisanship. Our case discussion suggests that Chinese credit can independently affect government policy choices, notwithstanding their partisan affiliations. Not only was a centrist government in Costa Rica able to tap Chinese financing to help boost its budgetary flexibility, but a leftist government in Bolivia without much Chinese financing remained fiscally disciplined.

5   Conclusion

Has China's emergence as a global creditor changed international finance? Is China's governance approach different from more traditional global lenders? In this paper, I have examined how a reliance on Chinese financing can effect the economic policy choices of debtor governments. Compared to those debtors primarily relying upon Western market financing, governments that primarily borrow from China tend to be more insulated from the scrutiny of global financial markets and international financial institutions. Why?

In evaluating sovereign credit, both global markets and Western governance institutions tend to emphasize the importance of policy conditionality, or prudent macroeconomic policies as a condition for new financing. Conditionality's cornerstone is a commitment to fiscal discipline. Such policy assurances help ensure high near-term financial returns by bolstering borrowers' finances and improving their debt repayment prospects. However, such short-term policy conditions also create a financing mismatch that hampers debtor countries' long-term development goals. This pattern is particular acute during economic downturns, when capital's exit threat often compels governments to implement austerity to mitigate financial volatility.

While Chinese creditors also are concerned with debt repayment, I contend that they offer a more patient

---

[83]Levitsky and Roberts 2011.

form of capital. By emphasizing non-intervention in sovereign affairs, the lack of conditionality extends the financing horizon beyond short-term policy targets. China's patient capital also tends to align better with country's long-term development goals by allowing countries to incrementally correct their policy errors without threatening financial destabilization. Chinese state-to-state financing packages are clearly aimed at creating export markets and commercial opportunities for Chinese firms, but they also tend to promote infrastructure and foreign direct investment as key drivers of longer-term economic growth. In this regard, Chinese creditors are often willing to endure business cycle risk if they are able to help Chinese companies globalize their operations by gaining cheap assets, market share, or improving key logistical skills such as marketing, distribution, and local engineering capabilities.

Based on these differences in financing structures, I have developed and tested a theory that shows that deficit spending increases with Chinese patient capital. In other words, I expect that national governments that borrow from China will have more degrees of maneuverability compared to other financing sources such as global bond markets. In a cross-national test of of Latin America – a region, that on average, has experienced massive growth of Chinese financing since the global crisis – I find that higher government budget deficits are positively associated with Chinese bilateral lending as a share of a nation's total external financing. This effect holds generally across the political spectrum, but the extreme or populist left tends to increase its budget deficits most sharply.

This comparative creditor framework offers several future research opportunities. If China remains committed to its non-intervention principle, how does it mitigate its credit risk without such policy conditionality? China's success in reaching its growth targets domestically during its miracle years reflected its ability to prosperously manage local investment projects. Can it also foster good governance internationally?

Rather than imposing policy conditions, China increasingly tempers its state-to-state credit risks by diversifying its investments to include market-based instruments. For example, in the wake of failed state-to-state investments in Sri Lanka, Indonesia, and Venezuela, China has created private equity funds (e.g., China-LAC Cooperation Fund, China-Latin America Infrastructure Fund) that are directly investing in corporate entities in manufacturing, energy, logistics and technology. It's also participating in public private partnerships (PPP) and varying its project financing partners to include Chinese commercial banks, multilateral

institutions (e.g. World Bank, Inter-American Development Bank) and local development banks.

To quantify to what extent China's overseas financing strategy now includes such market-based mecha-nisms, I plan to expand my *China Global Financial Index*, which codes Chinese investment projects by their financing channel (state vs. market), to include other developing region's projects from China's flagship external investment initiative, *Belt and Road Initiative* (BRI). I expect to find that China is experimenting with market-based solutions, and moving incrementally in its international economic efforts, much as it did during its domestic development. Such findings would suggest that its approach to global economic affairs is more pragmatic than ideological, meaning it may be more likely to defend than upend the liberal order.

Moving beyond this setting, it would also be interesting to explore the effect of other forms of patient capital on global borrowers. Does the pattern of greater debtor latitude simply reflect China's uniqueness as a creditor, or might bilateral loans from other nations also expand debtors' room to maneuver? Do private entrepreneurs borrowing from venture capital also receive more flexibility? How about non-profit institutions investing in social returns? By examining such types of patient capital, it would help us to understand to what extent a longer investment horizon is a sufficient condition for enhancing borrower autonomy.

These examples suggest that the notion of patient capital can be fruitfully extended in many ways. The globalization scholarship has long debated the extent to which mobile capital constrains national autonomy, often finding that local state capacity and institutional development can mitigate such globalization pressures. The above research agenda suggests that disaggregating the structure of mobile capital can also shed light on the conditions enabling greater sovereign autonomy. When creditors afford their debtors such policy autonomy, it creates a development opportunity by allowing nations to target longer-term societal welfare. However, it also transfers the burden of demonstrating creditworthiness squarely on the borrower. And with greater power, comes greater responsibility. If national governments do not invest the proceeds prudently, they risk squandering their sovereignty gains with mounting indebtedness.

References

Armijo, L.E. 1999. *Financial Globalization and Democracy in Emerging Markets.* New York: Palgrave.

Arnson, C. J., Heine, J., and Zaino, C., eds. 2014. *Reaching Across the Pacific: Latin America and Asia in the New Century.* Woodrow Wilson Center Press.

Ballard-Rosa, C. 2016. Hungry for Change: Urban Bias and Autocratic Sovereign Default. *International Organization* 70(2): 313-346.

Ballard-Rosa, C., Mosley, L., Wellhausen, W. 2017. Contingent Advantage? Sovereign Borrowing, Democratic Institutions, and Global Capital Cycles. *Unpublished manuscript.*

Baker, A. 2008. *The Market and the Masses in Latin America.* New York: Cambridge University Press.

Baker, A., and Greene, K.F. 2011. The Latin American Left's Mandate: Free Market Policies and Issue Voting in New Democracies. *World Politics* 63(1): 43-77.

Bunte, J. 2016. Wage Bargaining, Inequality, and Dutch Disease. *International Studies Quarterly* 60(4):2016.

Brooks, S.M., Cunha, R. and Mosley, L. 2015. Categories, Creditworthiness, and Contagion: How Investors' Shortcuts Affect Sovereign Debt Markets. *International Studies Quarterly* 59(3): 587-601.

Calvo, G. 1998. Capital Flows and Capital-Market Crises: the Simple Economics of Sudden Stops. *Journal of Applied Economics* 1(1): 35-54.

Carnes, M. 2014. *Continuity Despite Change: The Politics of Labor Market Regulation in Latin America.* Stanford: Stanford University Press.

Cerny, P. 1995. Globalization and the Changing Logic of Collective Action. *International Organization* 49: 595-626.

Corrales, J. 2000. Presidents, Ruling Parties, and Party Rules: a Theory on the Politics of Economic Reform in Latin America. *Comparative Politics* 32: 127-150.

Datz, G. 2009. What Life After Default? Time Horizons and the Outcome of the Argentine Debt Restructuring Deal. *Review of International Political Economy* 16(3): 456-484.

DeHart, M. 2012. Remodeling the Global Development Landscape: the China Model and South–South cooperation in Latin America. *Third World Quarterly* 33(7): 1359-1375.

Dietrich, S. 2013. Bypass or engage? Explaining Donor Delivery Tactics in Foreign Aid Allocation. *International Studies Quarterly* 57(4): 698-712.

Domínguez, J. 2006. China's Relations with Latin America: Shared Gains, Asymmetric Hopes. *China Working Paper.* Washington D.C.: Inter-American Dialogue.

Fairfield, T. 2010. Business Power and Tax Reform. *Latin American Politics and Society* 52(2): 51-71.

Ferchen, M. 2013. Whose China Model is it Anyway? The Contentious Search for Consensus.' *Review of International Political Economy* 20(2): 390-420.

Flores-Macías G.A. and Kreps, S. 2013. The Foreign Policy Consequences of China's Economic Rise: a Study of China's Commercial Relations with Africa and Latin America, 1992-2006. *Journal of Politics* 75(2): 357-371.

Frieden, J. 1987. *Banking on the World.* New York: Harper and Row.

Frieden J. 1991. Invested Interests: the Politics of National Economic Policies in a World of Finance. *International Organization* 45(4): 425-451.

Frieden, J. 2016. Macroeconomic Rebalancing in China and the G20. *China and the World Economy* 24(4): 15-33.

Gallagher, K.P. and Porzecanski, R. 2010. T*he Dragon in the Room: China and the Future of Latin American Industrialization.* Stanford: Stanford University Press.

Gallagher, K. P. and Myers, M. 2016. China-Latin America Finance Database. Washington D.C.: Inter-American Dialogue.

Gallagher, K.P. 2016. *The China Triangle.* New York: Oxford University Press.

Hallerberg, M. and Scartascini, C. 2017. Explaining Changes in Tax Burdens in Latin America: Do Politics Trump Economics? *European Journal of Political Economy* 48(c): 162-179.

Hardie, I., Howarth, D., Maxfield, S. and Verdun, A. 2013. Banks and the False Dichotomy in the Comparative Political Economy of Finance. *World Politics* 65(4): 691-728.

Hardie, I. and Maxfield, S. 2013. Market-Based Banking as the Worst of all Worlds: Illustrations from the United States and United Kingdom. In *Market-Based Banking and the International Financial Crisis,* edited by Iain Hardie and David Howarth. Oxford University Press.

Hellwig, T. 2014. *Globalization and Mass Politics: Retaining the Room to Maneuver.* New York: Cambridge University Press.

Kahler, M. 1998. Introduction: Capital Flows and Financial Crises in the 1990s. In *Capital Flows and Financial Crises,* edited by Miles Kahler. Manchester University Press.

Kaplan, S.B. 2006. The Political Obstacles to Greater Exchange Rate Flexibility in China. *World Development* 34(7): 1182-1200.

Kaplan, S.B. 2013. *Globalization and Austerity Politics in Latin America.* New York: Cambridge University Press.

Kaplan, S.B. 2016. Banking Unconditionally: The Political Economy of Chinese Finance in Latin America. *The Review of International Political Economy* 23(4):

Kaplan, S.B. and Thomsson, K. 2017. The Political Economy of Sovereign Debt: Global Finance and Electoral Cycles. *The Journal of Politics* 79(2): 605-623.

King, G., Keohane, R. and Verba, S. 1994. *Designing Social Inquiry: Scientific Inference in Qualitative Research.* Princeton, N.J.: Princeton University Press.

Kurtz, Marcus J., and S. M. Brooks. 2008. Embedded Neoliberal Reform in Latin America. *World Politics* 60(1): 231-280.

Lanxin, X. 2008. An Alternative Chinese View. In *China's Expansion into the Western Hemisphere: Implications for Latin America and the United States*, edited by Riordan Roett and Gonzalo Paz. The Brookings Institution.

Levitsky, S. 2003. *Transforming Labor-Based Parties in Latin America: Argentine Peronism in Comparative Perspective.* New York: Cambridge University Press.

Levistky, S. and K. Roberts., eds. 2011. *The Resurgence of the Latin American Left.* The Johns Hopkins University Press.

Luna, J.P. and , C.R. Kaltwasser, eds. 2014. *The Resilience of the Latin American Right*. The Johns Hopkins University Press.

Lupu, N. 2014. Brand Dilution and the Breakdown of Political Parties in Latin America. *World Politics* 66(4): 561-602.

Mahon, J.E. 1996. *Mobile Capital and Latin American Development*. The Pennsylvania State University Press.

Maxfield, S. 1998. Effect of International Portfolio Flows on Government Policy Choice. In *Capital Flows and Financial Crises*, edited by Miles Kahler. Cornell: Cornell University Press: 158-185.

McDowell, D. and Liao, S. 2016. No Reservations: International Order and Demand for the Renminbi as a Reserve Currency *International Studies Quarterly* 60(2): 272-293.

McDowell, D. and Steinberg, D. 2017. Systemic Strengths, Domestic Deficiencies: The Renminbi's Future as a Reserve Currency. *Journal of Contemporary China* 26(108): 801-819.

McNamara, K.R. 1999. *The Currency of Ideas: Monetary Politics in the European Union*. Ithaca: Cornell University Press.

Mearsheimer, J. 2001. The Future of the American Pacifier *Foreign Affairs* September/October.

Mosley, L. 2000. Room to Move: International Financial Markets and National Welfare States. *International Organization* 54(4): 737-773.

Mosley, L. 2003. *Global Capital and National Governments*. New York: Cambridge University Press.

Mosley, ,L., Wibbels, E., and Paniagua, V. 2017. Who is 'the Market' and What does it Want?: Public Policy, Bond Markets and Credit Default Swaps. *Unpublished manuscript*.

Murillo, M. V. 2002. Political Bias in Policy Convergence: Privatization Choices in Latin America. *World Politics* 54(4): 462-493.

Murillo, M. V., Oliveros, V., and Vaishnav, M. 2011. Voting for the Left or Governing on the Left? In *The Resurgence of the Latin American Left*, edited by Steven Levitsky and Kenneth Roberts. Baltimore: The Johns Hopkins University Press.

Myers, M, and Wise, C., eds. 2017. *The Political Economy of China-Latin American Relations in the New Millennium: Brave New World*. Routledge Press.

Nelson S. 2015. International Financial Institutions and Market Liberalization in the Developing World. In *Oxford Handbook of International Organizations*, edited by Carol Lancaster and Nicolas van de Walle. New York: Oxford University Press.

Pinto, P. M. 2010. The Politics of Hard Times: Fiscal Policy and the Endogeneity of Economic Recessions. *In Politics in the New Hard Times: the Great Recession in Comparative Perspective*, edited by Miles Kahler and David Lake. Cornell: Cornell University Press.

Roberts, K. M. 2002. Social Inequalities without Class Cleavages in Latin America's Neoliberal Era. *Studies in Comparative International Development* 36(4): 3-33.

Roberts, K.M. 2012. Market Reform, Programmatic (De) Alignment, and Party System Stability in Latin America. *Comparative Political Studies* 46(11): 1422-1452.

Roett, R. and Paz, G. 2008. Introduction: Assessing the Implications of China's Growing Presence in the Western Hemisphere. In *China's Expansion into the Western Hemisphere: Implications for Latin America and the United States*, edited by Riordan Roett and Gonzalo Paz. Brookings Institution Press.

Roett, R. and Paz, G., eds. 2016. *Latin America and the Asian Giants: Evolving Ties with China and India.* Brookings Institution Press.

Rudra, N. 2002. Globalization and the Decline of the Welfare State in Less Developed Countries. *International Organization* 56(2): 411-445.

Rudra, N. 2008. *Globalization and the Race to the Bottom in Developing Countries: Who Really Gets Hurt?* New York: Cambridge University Press.

Schweller, R.L. and Pu, X. 2011. After Unipolarity: China's Vision of International Order in an Era of U.S. Decline. *International Security* 36(1): 41-72.

Shambaugh, D. 2007. China's Quiet Diplomacy: the International Department of the Chinese Communist Party. *China: An International Journal* 5(1): 26-54.

Shambaugh, D. 2013. *China Goes Global: The Partial Power.* Oxford University Press.

Sierra, J. and Hochstetler, K. 2017. Emerging Power National Development Banks and Transnational Activist Networks *International Studies Quarterly* 61(4): 760-773.

Stallings, B. 2008. The US–China–Latin America Triangle: Implications for the Future. In *China's Expansion into the Western Hemisphere: Implications for Latin America and the United States,* edited by Riordan Roett and Gonzalo Paz. The Brookings Institution.

Stallings, B. and Kim, Eun Mee. 2017. *Promoting Development: The Political Economy of East Asian Foreign Aid.* Palgrave MacMillan.

Steinberg D. 2014. Why has China Accumulated such Large Foreign Reserves? In *The Politics of China's International Monetary Relations*, edited by Eric Helleiner and Jonathan Kirshner. Ithaca: Cornell University Press.

Stokes, S. C. 2001. *Mandates and Democracy.* Cambridge: Cambridge University Press.

Thacker, S. C. 1999. The High Politics of IMF Lending *World Politics* 52(1): 38-75.

Thacker, S.C. 2000. *Big Business, the State, and Free Trade: Constructing Coalitions in Mexico.* Cambridge: Cambridge University Press.

Tokatlian, J. 2008. A View from Latin America. In *China's Expansion into the Western Hemisphere: Implications for Latin America and the United States,* edited by Riordan Roett and Gonzalo Paz. The Brookings Institution.

Wade, R. 1998. The Asian Debt-and-Development Crisis of 1997-?: Causes and Consequences. *World Development* 26(8): 1535-1553.

Wade, R. 2007. A New Global Financial Architecture? *New Left Review* 46 (July-August): 113-129.

Weyland, K. 2002. *The Politics of Market Reform in Fragile Democracies: Argentina, Brazil, Peru, and Venezuela.* Princeton: Princeton University Press.

Weyland, K. 2009. The Rise of Latin America's Two Lefts: Insights from Rentier State Theory. *Comparative Politics* 41(2): 145-164.

Weyland, K., Madrid, R. and Hunter, W. 2010. *Leftist Governments in Latin America: Successes and Shortcomings.* New York: Cambridge University Press.

Wibbels, E. 2006. Dependency Revisited: International Markets, Business Cycles, and Social Spending in the Developing World. *International Organization* 60(2): 433-468.

Wibbels, E., and Ahlquist, J.S. 2011. Development, Trade, and Social Insurance. *International Studies Quarterly* 55: 125-149.

Winters, M. S. 2010. Choosing to Target: What Type of Countries Get Different Types of World Bank Projects. *World Politics* 62(3): 422-458.

Wise, C. and Quiliconi, C. 2007. China's Surge in Latin American Markets: Policy Challenges and Responses. *Politics and Policy* 35(3): 410-438.

Wise, C. 2018. *Dragonomics: The Rise of China in Latin America.* New Haven: Yale University Press.

Vreeland, J. 2003. *The IMF and Economic Development.* New York: Cambridge University Press.