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Indexes, Currencies, and the Political Economy of Sovereign Bond Market Access

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Inclusion in bond indexes improves emerging market (EM) government access to capital. Under what conditions do EMs enter indexes and gain the market access benefits? We find that borrower features affect index inclusion differently in domestic currency versus foreign currency bond contexts. In the higher-risk domestic currency bond context, indexes are designed to include only a small, low-risk subset of bonds, leading borrower political, institutional, and policy characteristics to significantly affect inclusion probability. In the lower-risk foreign currency bond context, indexes are designed to depict more of the market, so these same borrower features do not significantly affect inclusion probability. The study shows why EM entry into indexes and the corresponding access to capital vary across domestic currency and foreign currency bond markets, providing a nuanced picture of how contemporary sovereign debt markets operate. We provide historical index inclusion data for future research.

La inclusión en los índices de bonos mejora el acceso por parte de los Gobiernos de los mercados emergentes (ME) al capital. ¿Bajo qué condiciones ingresan los ME en estos índices obteniendo, de esa forma, los beneficios que conlleva el acceso al mercado? Encontramos que las características del prestatario repercuten de manera diferente sobre la inclusión en el índice en contextos de bonos en moneda nacional frente a contextos de bonos en moneda extranjera. En el contexto de bonos en moneda local, de mayor riesgo, los índices están diseñados para incluir solo un pequeño subconjunto de bonos de bajo riesgo, lo que hace que las características políticas, institucionales y en materia de políticas del prestatario tengan efectos significativos sobre las probabilidades de inclusión. En el contexto de bonos en moneda extranjera, de menor riesgo, los índices están diseñados con el fin de reflejar el mercado en mayor medida, por lo que estas mismas características del prestatario no tienen consecuencias significativas sobre las probabilidades de inclusión. El estudio muestra por qué la entrada de los ME en los índices y el acceso correspondiente al capital varían entre los mercados de bonos en moneda nacional y los mercados de bonos en moneda extranjera, lo que nos permite proporcionar una imagen matizada con relación a cómo operan los mercados de deuda soberana contemporáneos. Además, proporcionamos datos históricos de inclusión en índices para futuras investigaciones.

Après inclusion dans les indices obligataires, les gouvernements de marchés émergents (ME) bénéficient d'un meilleur accès au capital. Sous quelles conditions les ME font-ils leur entrée dans les indices obligataires et accèdent-ils au marché ? Nous remarquons que les caractéristiques des emprunteurs ont une incidence différente sur l'inclusion dans les indices pour les obligations en devise nationale et étrangère. Dans le contexte des obligations en devise nationale au risque plus élevé, les indices sont conçus de telle façon à inclure uniquement un petit sous-ensemble d'obligations à risque faible ; les caractéristiques politiques, institutionnelles et de politiques de l'emprunteur ont donc une incidence forte sur la probabilité d'inclusion. Dans le contexte des obligations en devise étrangère au risque plus faible, les indices sont conçus de telle façon à représenter une plus grande partie du marché. Ainsi, les mêmes caractéristiques de l'emprunteur n'ont pas d'incidence importante sur la probabilité d'inclusion. L'étude montre pourquoi l'entrée des ME dans des indices et l'accès au capital qui en découle varie dans les marchés obligataires en devise nationale et étrangère, apportant ainsi une représentation nuancée du fonctionnement des marchés contemporains de la dette souveraine. Nous fournissons des données sur l'inclusion historique dans les indices pour les travaux de recherche ultérieurs.

Introduction

A central question in international political economy (IPE) is how borrower politics, institutions, and policy choices affect emerging market (EM) government access to bond markets. Models typically assume investors monitor individual country features to assess risk and make investment decisions. This assumption overlooks an important practical shift in contemporary bond markets: the rise of index investment. Rather than carefully monitoring country-specific information, asset managers primarily allocate capital by tracking pre-constructed benchmark indexes. This is evident in both foreign and domestic currency EM bond markets—the International Monetary Fund (IMF) and Bank for International Settlements (BIS) estimate that passive index investment constitutes 80 and 90 percent of fund holdings in each

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market, respectively (Arslanalp et al. 2020, 9; Miyajima and Shim 2014, 24). Since most EM bond market investment is dictated by index composition, index inclusion grants EMs access to a vast pool of capital that they could not easily secure if excluded.

The scale of index investment makes index providers gatekeepers to EM sovereign bond markets. As the criteria that index providers use to determine index entry increasingly affect sovereign access to finance, indexes obtain "de facto regulatory power" as they "steer capital" (Petry et al. 2019). Investors have in effect delegated a significant degree of decision-making to index providers, and IPE has only begun to consider the implications for market access (Cormier and Naqvi 2023). We build on this work by comparing indexes in the foreign currency versus the domestic currency EM bond market, which are not designed the same—they include different proportions of their respective markets. For example, in 2016, the most important foreign currency EM bond index included 90 percent of eligible issuers of foreign-denominated bonds, while the most important domestic currency EM bond index included only 18 percent of eligible issuers of domestic-denominated bonds.[1] This suggests that the domestic index is more difficult to enter, giving rise to differences in EM access to each index—and the corresponding capital—in a financial world driven by index investment.

These stylized facts about the scale of index investment, the gatekeeping role of index providers, and varied index designs raise questions that have the potential to reframe how IPE understands and studies sovereign bond markets. Why do index designs differ in domestic versus foreign currency bond markets? Under what conditions do EMs gain the benefits of entry into each index—and do these conditions systematically vary by index design? We use multiple methods to answer these questions.

First, we use interviews with index providers and investors to create a typology of index design, ranging from mechanical to discretionary. Mechanical indexes depict the majority of a market, while discretionary indexes include only a small fraction of a market. The benchmark index in the foreign currency EM bond market is mechanical, automatically including bonds that meet a minimal set of formal criteria. In contrast, the benchmark index in the domestic currency EM bond market is discretionary. The index provider actively curates this index to include only a small subset of all domestic-denominated bonds, subjectively deciding which EM bonds to include on a case-by-case basis based on "several considerations including *but not limited to*" formal criteria (J. P. Morgan 2023, 2, emphasis added).

We then explain why index design differs across the two markets, which stems from the relative degree of risk for investors. Foreign currency bonds present less risk, so investors prefer a mechanical index that includes most foreign-denominated bonds. Domestic-denominated bonds are comparatively riskier, so investors want the index provider to curate a selective index. The result is that the benchmark domestic currency EM bond index includes only a small low-risk fraction of the domestic currency market, while the benchmark foreign currency EM bond index includes a much larger portion of the foreign currency market. Since the domestic currency index is more difficult to enter, inclusion criteria become a more significant constraint on EM market access in that context than in the foreign currency context.

[1]Authors' calculations; see figures 1 and 2.

Second, we present quantitative evidence that the constraints on entry to the domestic currency bond index are informal but systematic. In addition to macroeconomic fundamentals, inclusion depends on a set of borrower political and institutional features: government partisanship, democratic institutions, government transparency, and economic policy choices. These criteria for domestic index inclusion become a hurdle that many EMs do not clear, constraining market access. In contrast, these factors do not affect the probability of inclusion in the foreign currency bond index. The criteria for foreign index inclusion are less of a hurdle, so more EMs gain the benefits of inclusion. Borrower features affect index inclusion—and the corresponding market access benefits—differently in different markets.

We conclude by showing that, like the foreign currency index (Cormier and Naqvi 2023), once an EM is included in the domestic currency index, it is able to issue more domestic-denominated bonds regardless of those country-specific characteristics that determined entry in the first place. This confirms how the index gatekeeping effect in domestic currency bond markets operates in practice: the index is an additional constraint on market access until an EM gains inclusion. Post-inclusion improvement in market access also reifies why index providers carefully curate a low-risk subset of EMs to be included in the domestic currency index. Since index entry improves an EM's ability to issue domestic-denominated bonds, and domestic-denominated bonds are riskier for investors than foreign-denominated bonds, entry to the domestic index is more carefully managed than entry to the foreign index.

The study has several implications for the IPE of sovereign debt. Generally, it builds on work highlighting the importance of index inclusion for market access but further shows that the conditions under which EMs gain the benefits of index entry vary in foreign versus domestic currency bond markets (Cormier and Naqvi 2023; Petry et al. 2019). More specifically, the study provides a nuanced picture of how borrower features central to IPE theories of sovereign debt—democracy, partisanship, transparency, and policy choices—inform market access. Democratic institutions and government transparency affect domestic currency index inclusion and market access but not foreign currency index inclusion and market access, refining debate about whether and how a democratic advantage operates in sovereign debt (Ballard-Rosa et al. 2021; Beaulieu et al. 2012; Biglaiser and Staats 2012; Cormier 2023b; DiGiuseppe and Shea 2015). Government partisanship affects domestic but not foreign index inclusion and market access, clarifying the relationship between left governments and market access. Left-leaning EM governments may prefer to issue more bonds vis-à-vis other financing options (Cormier 2024), but the currency of those bonds likely depends on factors such as domestic institutions (Ballard-Rosa et al. 2022) and index inclusion. Certain macroeconomic policy choices impact domestic but not foreign inclusion and market access, reinforcing the point that borrower features do not affect access equally in all bond markets: just as developed and developing country market access depends on different factors (Mosley 2003), developing country access to domestic and foreign currency indexes and the corresponding markets depends on different factors.

Finally, replication materials provide historical inclusion data for the most widely used domestic and foreign currency EM sovereign bond indexes. Given the importance of index investment, we hope these data help researchers better account for investment practices that are central to understanding contemporary sovereign debt.

The Political Economy of Sovereign Bond Market Access

Traditional models of sovereign bond market access are based on uncoordinated market signals (Eaton and Gersovitz 1981; Tomz 2007). EM investors individually monitor country characteristics, use this information to assess default probability, then make capital available according to core risk indicators (Mosley 2003, ch. 4). These include macroeconomic fundamentals (Koepke 2019; Presbitero et al. 2016), partisanship or policies (Barta and Johnston 2023; Brooks et al. 2022), electoral cycles (Kaplan and Thomsson 2017; Vaaler et al. 2006), and institutional factors (Beaulieu et al. 2012; Biglaiser and Staats 2012; Cormier 2023b; Sadeh and Porath 2020; Sadeh and Rubinson 2024; Schultz and Weingast 2003). To be sure, the effects of these indicators are conditioned by a combination of information asymmetries (Brooks et al. 2015; Cunha 2024; Gray 2009; Mosley et al. 2020) and push factors such as global capital cycles (Ballard-Rosa et al. 2021; Bauerle Danzman et al. 2017; Naqvi 2019). Borrower preferences and strategies also affect flows observed in EM bond markets (Ballard-Rosa et al. 2022; Bunte 2019; Cormier 2024; Mosley and Rosendorff 2023; Zeitz 2022). But common across these models is the premise that uncoordinated market forces assess EM characteristics to set the terms of market access for borrowing EMs.

There are two limitations to this literature, which has not fully engaged with the evolution of investment practices. First is the rise of passive investment, where investor holdings are dictated by benchmark indexes (Arslanalp et al. 2020; Miyajima and Shim 2014; Raddatz et al. 2014). Because investors track the same indexes, flows become correlated. This concentrates decision-making power over bond holdings in the hands of the firms that provide indexes (Petry et al. 2019), essentially coordinating investment decisions (Hardie 2006, 59–60). Contemporary bond markets thus increasingly reflect governance features, where index providers serve a gatekeeping role and alter constraints on market access (Cormier and Naqvi 2023).

This is similar to the rise of credit rating agencies, which are seen to gatekeep financial market access through a certification role in risk assessment (Barta and Johnston 2023; IMF 2010; Pagliari 2012; Sinclair 2005). Indexes and rating agencies play different roles. While credit ratings provide information on individual EM risk, indexes provide information on how to invest across the entire EM asset class. While rating agency risk assessments remain influential, index providers have become as influential yet remain understudied. As noted above, index investment explains more than 80 percent of global fund holdings in both domestic and foreign currency EM bond markets (Arslanalp et al. 2020, 9; Miyajima and Shim 2014, 24). Like credit rating agencies, index providers' gatekeeper role stems from the authority to judge risk and affect financial flows.

Second, the literature typically focuses on foreign currency bond markets. But EM domestic currency bond markets have grown rapidly. From 2004 to 2019, the EM domestic currency bond market grew from $3 trillion USD to $24 trillion USD, making domestic-denominated bonds important for EMs even as the foreign-denominated bond market also grew (Dehn 2020, 2). Some large EMs have attracted foreign investors to their domestic currency bonds so successfully that they mostly issue domestic-denominated bonds (Aizenman et al. 2021; Hardie and Rethel 2019). Around 85–90 percent of non-OECD sovereign bonds issued from 2015 to 2020 were denominated in domestic currency, up from 56 percent in 1990 (Ballard-Rosa et al. 2022, 33, 38; Sampath 2022, 1).

IPE has begun probing reasons that EMs issue in domestic or foreign currency (Ballard-Rosa et al. 2022). But the expansion of EM domestic currency bond markets gives rise to broader questions about whether and how borrower features affect EM access to that market differently than in the foreign currency bond market. Given the increasingly important gatekeeping role of indexes described above, we examine how index design affects market access in domestic versus foreign currency EM bond markets.

The Rise of Index Investment in EM Sovereign Bond Markets

Institutional investors such as asset managers, pension funds, and insurance funds invest in EM bonds for higher returns than advanced markets and diversification from other asset classes such as equities or commodities. Since these characteristics are common across EMs as a group, investors typically want exposure to the entire asset class rather than individual countries (Arslanalp et al. 2020).

Indexes emerged in the 1970s as information sources that depicted entire asset classes (Wigglesworth 2021, chs 3–4). The ability to diversify investment across a type of asset (EM bonds, e.g.) theoretically optimizes risk and return because such an investment strategy accounts for all known market information (Fama 1970).[2] Moreover, in EM bond markets specifically, global investors often do not have the information or time to scrutinize domestic fundamentals in individual EMs (Brooks et al. 2015; Cunha 2024; Gray 2009; Naqvi 2019). Like rating agencies, EM bond indexes solve efficiency and information problems for asset managers interested in EM bonds as they make investment decisions (Sinclair 1994, 137).

These benefits explain the rise of index investment in EM bond markets, where investors allocate capital by tracking benchmark indexes rather than picking individual bonds. When a country is included in a benchmark index, passive investors replicating the index buy the included country's bonds. Even active investors closely follow indexes, using them to benchmark before making minor adjustments to try producing higher returns than the index (Arslanalp et al. 2020, 9; Miyajima and Shim 2014).[3] Most EM bond investment is explained by what countries are included in indexes.

J. P. Morgan Index Dominance and Design

As index-driven investment became widespread, J. P. Morgan (JPM) became the primary EM bond index provider, tracked by a far greater volume of capital than other indexes (Arslanalp and Tsuda 2014, 9; State Street 2020). In the EM foreign currency sovereign bond market, JPM's Emerging Market Bond Index Global (EMBIG) is tracked by an estimated $342 billion USD (J. P. Morgan 2021, 90). In the domestic currency bond market, JPM's Government Bond Index-Emerging Market (GBI-EM) is tracked by an estimated $247 billion USD (J. P. Morgan 2021, 117). Asset

[2]This is the "efficient market hypothesis," on which there is a vast literature that informs the colloquial idea that no one can "beat the market" by picking individual stocks or bonds.

[3]Indexes also facilitate performance comparison between passive and active funds, as a large asset manager explains: "we use indexes for our clients to assess the performance of various funds. If we all used different approaches, it would be hard for clients to know which fund is doing better than the other" (Interview 6).

managers explain "at the end of the day, there are a number of EM indices out there, but the ones that most of my peers in the industry [EM investors] use … are really the same two … and they come from the same company, J.P. Morgan."[4]

JPM designs index inclusion criteria in consultation with its clients, which are investors. According to one index provider employee, "we take the aggregated view of investors and pass this on to the governments … we have close relationships with governments and big investors and go back and forth."[5] Consultations include annual "Index Governance Council" meetings, to which large and small investor clients are invited. But as important are regular informal discussions with the largest ten to fifteen asset management firms.[6] According to one large asset manager, "there is no question that the big investors are more important in the consultations with JPM than the small investors. These ten firms make up most of the index business. So JPM needs to know in advance not necessarily their agreement [with JPM's index decisions], but that they will follow and be okay with [decisions]."[7]

Indeed, since there is rarely full consensus across investors, JPM must make independent decisions despite client consultation. Some investors want JPM to be more stringent with inclusion/exclusion decisions. One portfolio manager at a major EM investment fund argued "they are not careful enough about the countries they add. For instance, we complain when JPM comes and says I want to include Kazakhstan. We say no because it simply doesn't have the local liquidity to accommodate in case there is an exclusion and sell off … JPM also doesn't care enough about left governments, but we care a lot about this." In contrast, other investors want more countries to be represented in the index. According to one EM asset manager: "fewer than 10 percent of EM countries are represented in the … JPM GBI-EM … the poor representativeness of indices ought to worry investors, EM issuers and policymakers alike. More and more money is being funneled into an ever narrower set of EM local markets, where concentration risks rise as a result" (Dehn and Arthur 2015, 4). Investors also disagree over specific country inclusion/exclusion decisions. According to an index provider, "there is divergence between investors, for instance on Russia and China. Some investors [may be] quick to say we don't want Russia in the index [but others aren't]. Different clients' mandates might prevent them from investing in China."[8]

Taken together, while major investors have input, JPM makes the ultimate decisions about index composition. According to an index provider, "managing divergent investor voices is very difficult when we make a benchmark change. We also have a lot of our own internal legal and governance procedures to follow."[9] This of course opens space for the above investor criticism of JPM's control and decisions.

JPM thus serves as a vital link between investors and governments in shaping EM bond market access. For their part, EM Debt Management Offices (DMOs; see Cormier 2024; Sadeh and Porath 2020; Sadeh and Rubinson 2024) are aware of the implications of JPM's inclusion/exclusion decisions for bond market access. But DMOs themselves cannot easily influence JPM decisions. In the words of one multilateral expert, the factors JPM scrutinizes when making inclusion criteria and decisions are institutions and policies that "are made at a pay grade far above" DMO influence at home.[10] In other words, factors identified as central to JPM decisions in this study (rule of law, partisanship, transparency, or exchange rate policies) are either broad political processes or macroeconomic policy choices that DMOs cannot easily influence let alone control.

JPM's primary business aim is maintaining its dominant market share by providing investor clients with index products that match their investment strategies for each market. This helps explain different index designs in foreign versus domestic currency bond markets, as we detail next.

Varied Index Design and Risk Perception across Foreign and Domestic Currency EM Bond Markets

In practice, no index truly depicts an entire market. Index providers such as JPM necessarily exercise some degree of judgment in deciding what constitutes "the market," and how much of it to include, when designing indexes. For the IPE of sovereign debt, these design decisions are important because they determine the probability that the EM will enter an index and gain the market access benefits of inclusion. The more difficult it is to enter an index, the more the index constrains access to vast pools of index-tracking capital.

Figures 1 and 2 show that domestic and foreign currency EM bond indexes capture different subsets of their respective markets. The domestic index never included more than eighteen EMs through 2019—a fraction of the seventy-three EMs included in the foreign index by 2019. In terms of eligible bond issuers, the domestic index never included more than 21 percent of the eligible EMs that issued domestic currency bonds each year—while the foreign index has included up to 90 percent of eligible issuers. Figure 3 shows that the volume of domestic-denominated EM bonds excluded from the domestic currency bond index was large and growing over the timeframe of this study. Despite the exponential growth in EM use of domestic-denominated bonds, the domestic currency index includes far less of its market than the foreign currency index does of its market.

Online Appendix A lists all countries included in each index each year. The relative ease or difficulty of entry is evident in comparing the variety of countries included in the foreign but not the domestic index.

Why do these indexes include such different proportions of each market, gatekeeping access to capital to different degrees? Drawing on fifteen semi-structured interviews with current and former index provider employees and EM portfolio managers at asset management firms, as well as primary documents, we (1) create a typology of index design and (2) explain why index design varies across domestic and foreign currency contexts. See Online Appendix B for interview details and methodology.

The reason for different index designs is that investors perceive domestic currency bonds as riskier than foreign currency bonds. Because JPM's primary aim is to give clients index products that match their investment strategies for each context, index design varies by the risk in each market. In the comparatively lower-risk foreign currency bond market, indexes are designed to be *mechanical*, capturing

[4]Interview 5.
[5]Interview 12.
[6]Interviews 1, 5, 6, 12, 13, and 14.
[7]Interview 6.
[8]Interview 13.
[9]Interview 14.
[10]Interview 15.

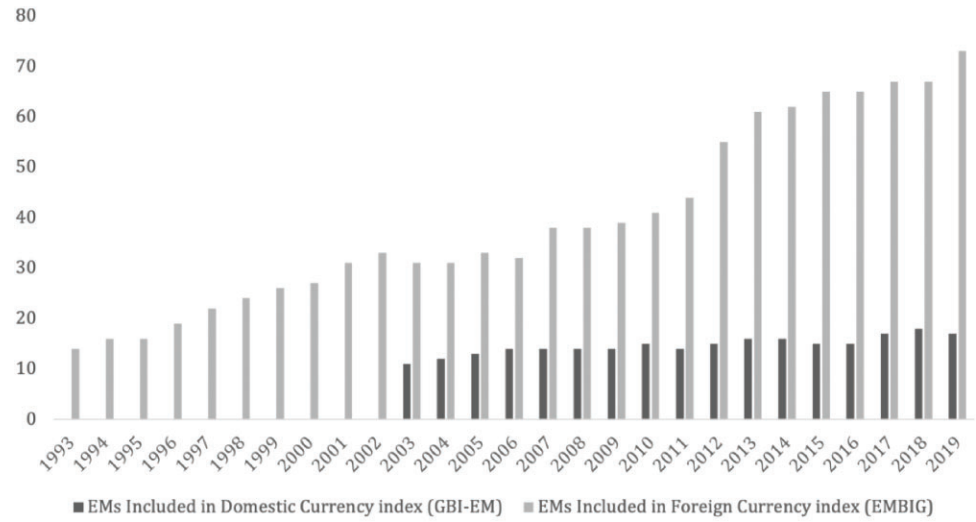

Figure 1. Countries included in each index. *Note*: Authors' data, available in replication materials. GBI-EM began in 2003, EMBIG began in 1993.

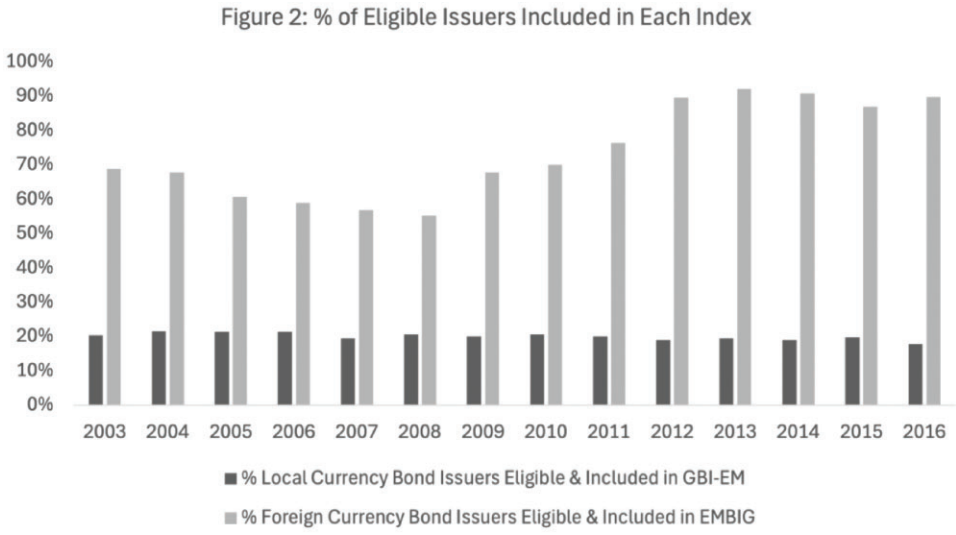

Figure 2. % of eligible issuers in each index. *Note:* Authors' calculations using authors' data with Ballard-Rosa et al (2022) data, which end in 2016. Comparison begins in 2003, the first year of GBI-EM. These comparisons are only available through 2016, the latest available year of the currency-based bond issuance data from Ballard-Rosa et al. (2022).

most of the market by automatically including any bond that meets a minimal set of formal criteria. In contrast, in the comparatively higher-risk domestic currency bond market, indexes are *discretionary*. These indexes are designed to include only a low-risk subset of the market, ensuring index providers make careful inclusion decisions on a case-by-case basis with room for informal assessments of bond issuers.

These differences, explained in detail below, are summarized in Table 1. The key is the italicized "additional country eligibility criteria" column—despite similar formal eligibility criteria for each index, JPM explicitly maintains additional informal decision-making discretion beyond formal criteria in the domestic currency context, but not the foreign currency context.

Risk and Index Design in Foreign Currency EM Bond Markets

Foreign currency EM bonds are a well-established asset class perceived as less risky than domestic currency EM bonds due to reduced currency risk. These bonds are also typically issued in New York or London, leaving them unaffected by capital controls and subject to foreign law in case of default. These risk-reducing features lead more global investors to hold foreign-denominated EM bonds than domestic-denominated EM bonds,[11] making the secondary market for foreign-denominated bonds more liquid than the market for domestic-denominated bonds (see

[11] In 2023, for example, an (unweighted) average of 64 percent of foreign investor bondholdings across the twenty-two largest EMs were in foreign currency. This number rises to 95 percent when including all middle- and low-income countries (Arslanalp and Tsuda 2014, authors' calculations).

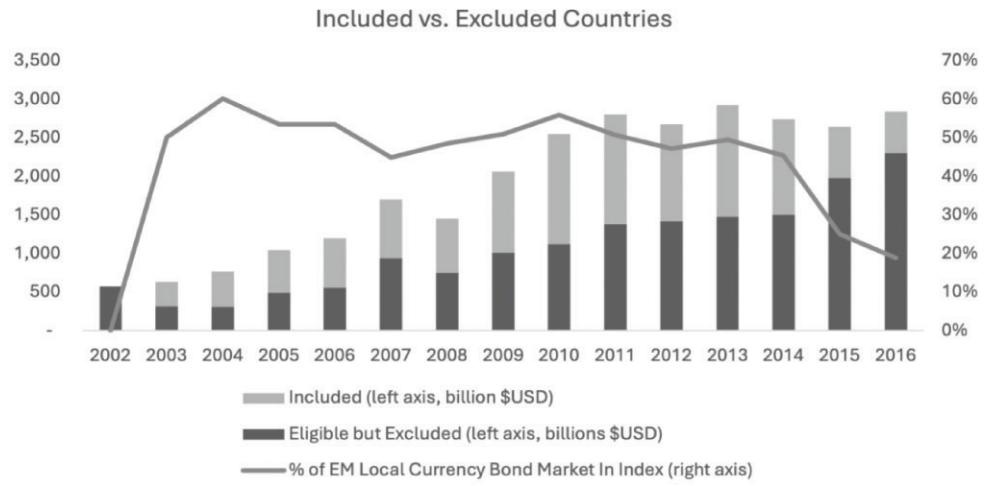

Figure 3. EM domestic currency bond market capitalization: included vs. excluded countries. *Note*: Authors' calculations using Ballard-Rosa et al (2022) data, which ends in 2016.

Table 1. J. P. Morgan index design comparison.

Index and market	Country eligibility criteria	***Additional country eligibility criteria***	Bond eligibility
EMBIG (foreign currency)	Inclusion: Below national income threshold Exclusion if Already Included: Above national income threshold for 3 years AND Above investment grade ratings threshold for 3 years at all three major ratings agencies	***Inclusion limited to formal criteria***	USD bonds above $500 million
GBI-EM (domestic currency)	Inclusion: Below national income threshold Exclusion if already included: Above national income threshold for 3 years AND Above investment grade ratings threshold for 3 years at all three major ratings agencies	***Inclusion "not limited to" formal criteria (J. P. Morgan 2023, 2); additional subjective country risk assessments on an informal basis***	Domestic currency bonds above $500 million USD in value

Van Doornik et al. 2024, 61)—it is easier for investors to sell foreign-denominated EM bonds when they wish.[12] Risk in foreign-denominated bonds largely stems from sovereign default risk, given "original sin" challenges (Eichengreen et al. 2007).

Easier tradability and narrow risk mean investors want broad exposure to the EM foreign currency bond asset class. Accordingly, the purpose of JPM's foreign currency EM sovereign bond index (the EMBIG) is not to pick only the most creditworthy countries. It is to provide an index that depicts most of the market and allows investor diversification across most of the asset class. As a result, the EMBIG uses a limited, formal set of inclusion criteria. The index automatically includes all USD bonds of a relatively small size issued by countries below JPM's national income threshold.[13] JPM makes no additional assessments about the sovereign issuer's default probability, repayment capacity, or economic and political features (J. P. Morgan 2018). Other indexes covering the EM foreign currency bond market, even if tracked by less capital than JPM's EMBIG, are also designed to be mechanical (see, e.g., Bloomberg 2023).

In the words of one index provider: "EMBIG is pretty much all encompassing. Once you issue [foreign] currency, it's New York law, it's tradeable on most exchanges … it's easy to get into EMBIG."[14] Other index providers explain that the mechanical design is transparent because inclusion is only about country income level: "on [foreign] currency indexes we just have income criteria and just look at whether the country meets it or not. If we change [that basic inclusion criteria] we need to have a consultation with our clients, ask the index users if they are okay making changes … but [that is rare and] if there is no rule change then clients themselves can figure out if a country will come in or not because [income level] data is widely available."[15]

[12]Symbolic of this, as noted earlier, $100 billion USD more capital tracks the foreign than the domestic index.

[13]J. P. Morgan's income ceiling ($19,713 GNI per capita in the final year of our data) is designed to include all middle- and low-income countries and some high-income countries with less developed financial markets.

[14]Interview 13.

[15]Interview 1.

Risk and Index Design in Domestic Currency EM Bond Markets

In sharp contrast, the dominant index in the domestic currency bond market, JPM's GBI-EM, is designed to include only a small fraction of that market. Although institutional investors use domestic currency EM bonds for similar yield and diversification purposes as foreign currency bonds, domestic currency bonds are riskier. While investors and index providers see default as the primary risk in foreign currency debt, domestic debt is seen to carry additional risks, including currency risk, domestic interest rate risk, legal risk, and ultimately liquidity risk.

Currency risk arises since exchange rate volatility or currency devaluation can affect investor returns (Gadanecz et al. 2014, 2), which is not present in the foreign currency context since they are paid in reserve currency. Domestic interest rate risk intensifies currency risk, as monetary policy easing can devalue currency and any bonds denominated in it (Burger and Warnock 2007; Claessens et al. 2007; Onen et al. 2023, 1, 9–10). If domestic-denominated bonds are governed by domestic law, sovereigns maintain the discretion to unilaterally change legal characteristics of bonds. These risks are muted for foreign-denominated bonds subject to New York law (Gelpern and Setser 2004).

Finally, liquidity risks—the ease of buying and selling—are more salient in the domestic than foreign currency context. This depends primarily on factors such as capital controls, taxes on foreign investors, and the size and diversity of the investor base, which create transaction costs when buying and selling. Liquidity risks are heightened for domestic compared to foreign bonds issued abroad, which bypass capital controls and taxes (Sampath 2022). On the investor base, the market for an EM's domestic-denominated bonds typically includes far fewer foreigners than the market for its foreign-denominated bonds (as noted above). Narrow investor bases increase the risk of insufficient buyers when investors sell, increasing price volatility and risk of losses for investors (Cormier 2025; Ocampo et al. 2025; Van Doornik et al. 2024). In the words of a portfolio manager at a domestic currency fund: "what is an investible country for us [in domestic debt]? A country offering enough liquidity, meaning we can enter and exit in an efficient way, with low trading costs and no capital controls. What's important is that when we decide we don't like South Africa anymore there will be interest from others to buy and we can leave. On the other hand foreign investors can easily buy hard currency debt because its issued abroad and requires no local infrastructure."[16]

Taken together, domestic bonds present more risk for investors than foreign currency bonds for several reasons. As a portfolio manager at an EM fund summarizes, "in [foreign] currency it is mainly credit [i.e., default] risk, but in local debt it is also interest rate risk and currency risk [and tradability risk] in addition to credit risk. We even used to say EMs default on external debt but not local. However now, for instance in Ghana and Sri Lanka, they have also defaulted on the domestic debt market. So you now have [default with] all these extra [traditional] risks … it is complicated to invest in domestic debt … [foreign] bonds are so much easier."[17]

Index Design Given Increased Risk

While more risk means higher returns, it also means investors are more concerned with mitigating risk than when holding foreign-denominated bonds. According to one former index provider, "what the [domestic currency] index is selling is the ability to navigate political shocks. Because what you want is to be able to offer expertise on [managing] changes in government" given the increased risk.[18]

The need to manage additional risk means investors do not want an index that simply captures most domestic-denominated bonds. Instead, they want the index provider to curate an index of a lower-risk subset of domestic currency bonds by making case-by-case inclusion decisions. Index providers explain that while the foreign currency index is "all encompassing" and "easy" to get into, "with domestic markets its more niche. Not all markets are equal."[19] Investors acknowledge "*[the greater risk means] it is complicated [and] is why JPM tends to be more selective in the local currency index.*"[20]

JPM has incentives for caution when making domestic currency index inclusion decisions because, in the words of one investor, "its about market share … they don't want to lose clients."[21] If JPM is to remain a credible index provider, they cannot provide an index with countries that are likely to cause losses for clients—particularly by including EMs that later will be dropped. According to a former index provider, "the moment you remove a country from the index, investors will have to sell. They might have no buyers [given lower liquidity in secondary markets for domestic currency bonds]. So that would be a reputational risk for the index provider" if they caused major losses for clients by including overly risky countries.[22] Another provider corroborates "the worst thing that could happen is that a country gets in and then must be removed … [if] it became really hard for investors to sell [what the index previously told them to hold] … there [would be] overwhelming anger amongst investors."[23]

Such strong cautionary incentives do not exist in the foreign currency context. According to a large investor, "the index provider must create a reliable product. In the foreign currency index this doesn't matter as much because it is easy to buy and sell the bonds. In the domestic market it is much harder, so the provider has to be careful about which countries they include in order to prevent reputational damage."[24] The relationship between risk and index design in domestic versus foreign currency bond markets described above is summarized in figure 4.

To this end, JPM's domestic currency index starts with the same formal national income level criteria as the foreign currency index (Table 1). However, country inclusion decisions are made in a second step, where JPM makes additional informal assessments of sovereign risk. JPM emphasizes that domestic index inclusion decisions are "subject to several considerations including *but not limited to*" explicitly stated formal criteria (J. P. Morgan 2023, 2, emphasis added).

In other words, in the domestic currency context, JPM exercises discretion not only when designing initial eligibility criteria, but also in making subsequent inclusion decisions.

[16]Interview 6.
[17]Interview 7.
[18]Interview 11.
[19]Interview 13
[20]Interview 7.
[21]Interview 8.
[22]Interview 11.
[23]Interview 12.
[24]Interview 5.

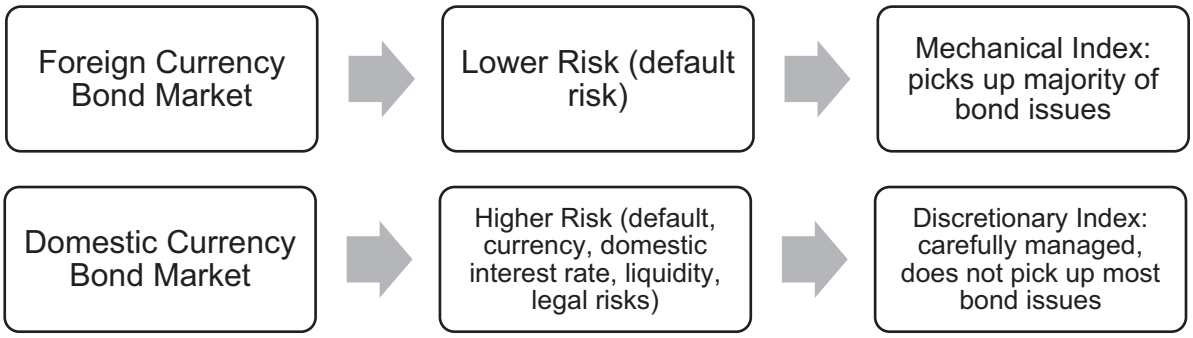

Figure 4. Risk levels and corresponding index design in EM bond markets

In sharp contrast to the mechanical foreign currency index, these subjective assessments go beyond formal quantitative criteria and allow informal consideration of a range of EM characteristics. An index provider explains that "JPM wants to make sure the [domestic currency] index is replicable by inserting bonds of as many countries as possible to make it varied and spread the risk, but also making sure that those bonds are liquid enough to be traded. How does it do that? *There is no hard and fast rule. There is a certain understanding, and you won't find it spelled out in any document. JPM leaves themselves some leeway.*"[25] Another index provider corroborates that in the domestic currency index, "inclusion comes down to an assessment of 'investability'. There are certain criteria that a country [must] have … but beyond that 'investability' *is a tough thing to put a finger on … you can't take anything out of the equation … you have to look at every factor. But when it comes to the [foreign] currency index 'investability' is less of a concern.* Because its bonds are issued in dollars, inclusion is just about if bond size is above a certain threshold."[26]

Ultimately, this helps explain why JPM keeps GBI-EM inclusion criteria informal (rather than formal and transparent like the foreign currency EMBIG). Due to the expanded risk sources in domestic-denominated bonds, informality ensures JPM maintains the discretion to assess a host of factors and make subjective judgments. The relative importance of different risk factors may change across countries or over time, making flexibility beneficial.

"Investability" in the domestic currency context depends in the first instance on capital controls, given implications for tradability. As a large investor explains, capital controls "are a big issue for domestic debt … its so different from [foreign] currency."[27] But this is far from the full list of factors that influence JPM's inclusion/exclusion decisions, as analyzed in the rest of the study.

Hypotheses: The Role of Politics in Different Indexes

The preceding discussion makes clear that JPM informally assesses a range of factors when making inclusion decisions for the domestic currency index. This stands in sharp contrast to the foreign currency index, where investors emphasized that "*in foreign currency you wouldn't care that much about all these things.*"[28] Beyond macroeconomic fundamentals and capital controls, interviews emphasized political features, institutional characteristics, and policy choices that inform JPM's domestic currency index inclusion decisions. We review these interviews to identify hypotheses about the specific ways in which entry into the domestic currency index depends more on political, institutional, and policy variables than entry into the foreign currency index.

First, interviewees emphasized partisanship. Index providers and investors shared concerns that left-leaning governments were more likely to implement policies that could increase domestic currency bond risk. Leaving aside debates about the validity of these views, left governments were discussed as more likely to increase fiscal deficits, oversee higher inflation or currency devaluation, and impose capital controls or other interventionist policies. According to one investor involved in JPM's index consultations, "the question is how you will fund the policy program … if you want to give free education, increase the minimum wage, how will you fund it? If it means you have increased public deficit it means more debt issuance … it might harm confidence of domestic and foreign investors … it can cause inflation. Partisan politics is a big driver of this type of thing."[29] Similarly, a former index provider noted "is an election going to result in a completely different political set-up? We don't really mind as long as obviously it doesn't bring about a set of policies that [increase risk]."[30] We hypothesize that left-leaning governments are less likely to be included in the discretionary domestic currency index. We do not expect this effect on the probability of inclusion in the mechanical foreign currency index.

Interviewees also highlighted democratic institutions. A large investor notes JPM plays a vital role in assessing institutional quality on behalf of investors: "things like property rights, rule of law are important for JPM's inclusion decisions. They are important for us too, but harder for us to measure and anticipate."[31] A former index provider further notes concern that non-democracies might be more likely to deviate from open macroeconomic policies: "in countries with more autocratic type of rule … how is that going to affect policy? Is it going to be that then decisions are less based on macroeconomic principles [like capital mobility and debt repayment]? If that is the case how is that going to impact the macroeconomic picture moving forward? Maybe it's not an impact in the immediate term but in the medium term, that is something we are concerned about."[32] Again, leaving aside debates about validity of these views, we hypothesize that democracies with stronger rule of law are

[25] Interview 5.
[26] Interview 9.
[27] Interview 7.
[28] Interview 7.
[29] Interview 8.
[30] Interview 5.
[31] Interview 6.
[32] Interview 5.

more likely to be included in the domestic currency index. We do not expect this effect on the probability of inclusion in the mechanical foreign currency index.

Similarly, government transparency affects country inclusion decisions because this makes it easier to anticipate how government policy changes might impact risk. An investor explains it is important to know, "beyond central bank independence, what are the rules in terms of the budget process? Do you have reviews, checks and balances? This transparency is not always present in EMs. They wouldn't tell you why they have breached some plan."[33] We hypothesize that transparent governments are more likely to be included in the domestic currency index. We do not expect this effect on the probability of inclusion in the mechanical foreign currency index.

Finally, interviewees indicated that JPM scrutinizes exchange rate policy. Interviews indicate JPM prefers floating regimes compared to the risk of speculative currency attacks or abrupt rather than gradual devaluations in pegged regimes. According to a large investor, "the main countries in the [domestic index] are not pegged … you cannot peg currency for free, for this you have to sell dollars. This means … eventually you cannot face foreign exchange liabilities [including debt payments]."[34] According to another large investor, "currency regime is important. A peg can work but you have to accept it from a political and stability point of view … floating is better [for debt]."[35] In other words, because pegs are costly to maintain over time and increase the probability of major exchange rate and currency adjustments in the medium term, these policy choices increase risk for investors holding domestic-denominated bonds. We hypothesize that EMs with currency pegs are less likely to be included in the domestic currency index. We do not expect pegs to affect the probability of inclusion in the mechanical foreign currency index.

Empirical Analysis

To test our hypotheses, we compare the conditions under which EMs are likely to be included in JPM's domestic currency index (GBI-EM) versus its foreign currency index (EMBIG). We first test our hypotheses in the domestic context then the foreign context, and compare the importance of borrower features in each. We find local currency index inclusion—but not foreign currency index inclusion—systematically depends on borrower political, institutional, and policy features. This evidence has important implications for understanding EM bond market access in a world driven by index investment.

Sample

To identify how JPM manages GBI-EM index inclusion, we build a panel of index-eligible EM countries. Sample data run from 2002 through 2019, beginning a year before GBI-EM's January 2003 inception. We scope the sample based on GBI-EM eligibility criteria. To enter GBI-EM, a country's Gross National income (GNI) per capita must be below JPM's Index Income Ceiling (IIC) for 3 consecutive years. The base IIC level, set in 1987, was US$6,000 GNI per capita (J. P. Morgan 2021, 40). JPM adjusts the IIC every year by the growth rate in world GNI per capita. We calculate annual IIC levels per this formula and drop ineligible countries. Our calculations indicate no country has been removed from the index for becoming too wealthy over the lifetime of GBI-EM. We drop countries with a population under one million.

Dependent Variable and Covariates

The dependent variable is binary. $DV = 1$ if a country was included in GBI-EM that year and $= 0$ if not. Online Appendix A details this data, including a list of the years EMs were included in the index.

GDP and *GDPgrowth* control for the size and health of a borrower's economy. *Inflation* is critical to assessing domestic currency debt risk. *Reserves* imply a country has enough foreign exchange to handle repayment challenges and sterilize currency volatility. *ExtDebtStock* increases default risk. Data are from the World Development Indicators.

CreditRating, the best credit rating a country has from Fitch, Moody's, or S&P, is obtained and coded numerically via Bloomberg. *DefaultLast2Yrs* codes whether the sovereign has defaulted on any form of debt in the last 2 years (Beers and Mavalwalla 2017), the timeframe associated with post-default market exclusion (Gelos et al. 2011).

FinancialDepth is the IMF's financial development index (Svirydzenka 2016, 5–6). Higher scores should yield greater access to domestic currency investors and a greater probability of inclusion in the GBI-EM (Berensmann et al. 2015; Claessens et al. 2007). In alternative specifications, we use *BwngPrivileges* to account for legal requirements that entities hold government debt (Betz and Pond 2025), but these are relegated to the Online Appendix due to large N loss.

We include partisanship via the Database of Political Institutions (DPI; Beck et al. 2001), coding perception of governing parties' economic policy orientation. While less useful in some political science applications (Rudra and Tobin 2017), DPI variables are helpful here because they reflect perceptions of economic policies (see Ballard-Rosa et al. 2022). Capturing such perceptions is what we aim to test for in the context of JPM's scrutiny of sovereign issuers. *Left* $= 1$ if a government is coded as left-leaning and 0 otherwise.

Peg codes whether the country has a pegged or tightly managed exchange rate (Ilzetzki et al. 2019). Capital controls (*CapAcctOpen*) are included since restrictions on capital mobility may preclude countries from index entry (Chinn and Ito 2006). Central bank independence (*CBI*) can affect inflation risk (Garriga 2025).

Rule of *Law* is from the Varieties of Democracy dataset (Coppedge et al. 2021). *GovtTransparency* is from the most widely used government transparency dataset (Hollyer et al. 2014), re-estimated by other studies to expand its time coverage (Cormier 2023a).

We include annual changes in 10-year US Treasury rates to control for global appetite for EM debt (Ballard-Rosa et al. 2021; Zeitz 2022). We lag all controls and include time effects through the annualized 10-year US Treasury rates.

Lagged dependent variables control for prior inclusion. This with standard errors robust to unit clustering account for unit heterogeneity instead of unit fixed effects for four reasons. First, since many EMs do not move in and out of the index, unit fixed effects perfectly predict outcomes to such an extent that fixed effect models are unidentifiable. Second, unit effects would cannibalize the importance of any non-varying explanatory variables within unit. Third, we avoid the incidental parameter problem given a short panel and a non-linear outcome (Greene 2004). Fourth, since JPM prioritizes minimal movement of countries in and out of indexes, between-unit variation is an important quantity of interest.

[33] Interview 8.
[34] Interview 7.
[35] Interview 6.

Models

Our interest is in the EMs that JPM includes in its domestic currency index, which is a fraction of all domestic currency EM bond issuers each year (figs 1–3). We accordingly estimate two-stage probit selection models. The first stage estimates the probability that an EM issued a domestic currency bond at all, obtained from a study of Bloomberg records (Ballard-Rosa et al. 2022) and grouped by year to fit the annual panel. The second stage then models the probability of a country being included in the index, controlling for the probability of it having issued a domestic currency bond in the first place.

The first stage includes all covariates listed above that one would expect to affect the ability to issue local-denominated bonds. The first stage also requires instruments excludable from the outcome stage. We include environmental disasters, as this may increase bond issuance but not index inclusion judgments. We also leverage studies highlighting that EM borrowers have the autonomy to use different sources of finance when they borrow (Ballard-Rosa et al. 2022; Bunte 2019; Cormier 2024; Mosley and Rosendorff 2023; Zeitz 2022). We control for the use of financial instruments other than domestic-denominated bonds, reasoning that use of alternative financing affects the probability of issuing a domestic bond at all but is less likely to significantly affect the probability of being included in the index once that bond is issued. We sum the volume of foreign currency bond issues each year and the volume of official credit borrowed each year, divide by GDP, then difference the variable. We thus control for year-over-year change in the extent to which EM governments borrow from other sources. We finally add a control for debt service, as large debt repayments may lead a country to not issue domestic bonds but prioritize obtaining foreign currency instead. Wald tests validate this selection stage specification by rejecting the null hypothesis that the coefficients in this first-stage model are jointly zero.

Results

Table 2 reports estimations. Model 1 is a baseline single-stage probit without selection. Model 2 is another baseline probit adding the lagged dependent variable. Model 3 is a two-stage selection model without a lagged dependent variable. Model 4 is the full two-stage model, including a lagged dependent variable. Model 5 addresses post-treatment bias by removing credit ratings and CBI from both first and second stages, testing whether the removal of these variables adjusts the relationship between inclusion and other variables.

Controlling for macroeconomic fundamentals, the hypothesized political, institutional, and policy factors are significantly associated with JPM's decision to include issuers of domestic-denominated sovereign bonds in its domestic currency index. This is evidence that JPM has systematic, if informal, preferences as it serves as a gatekeeper in the domestic currency EM sovereign bond market.

First, institutions inform JPM's inclusion decisions. EMs with stronger rule of law and greater transparency are more likely to be included. This is a provocative finding insofar as much recent literature questions arguments about a "democratic advantage" in sovereign debt. In the relatively risky market for domestic-denominated EM sovereign debt, democratic institutions may indeed yield an advantage through index inclusion and thus increased market access (among a large literature cited earlier, see Beaulieu et al. 2012; Biglaiser and Staats 2012).

Second, there is evidence that JPM has political and policy preferences. Left-leaning governments are less likely to be included, reflecting long-standing claims that left-leaning policies are disciplined by markets. Pegged exchange rates make countries less likely to be included, reflecting views that pegs increase medium-term currency risk by delaying adjustment. These relationships are evidence that JPM scrutinizes policy choices as a gatekeeper seeking to curate a low-risk index of domestic currency EM bonds.

The significant relationships between these political factors and index inclusion decisions exist while controlling for macroeconomic and financial development variables that, where statistically significant, perform as expected. More indebted countries and countries with lower reserve levels are less likely to be included. Countries with better credit ratings and developed domestic financial markets are more likely to be included.

Notably, we do not find that capital controls significantly affect the probability of inclusion, despite open capital accounts being oft-cited as necessary for "investability" and thus inclusion in the domestic index. Given strong priors that capital account openness should be associated with inclusion, we probe this non-finding in detail in Online Appendix C. There, descriptive statistics show many EMs with open capital accounts remain excluded from the index—signaling a minimal degree of capital account openness is likely a necessary but insufficient condition for inclusion. Furthermore, *CapAcctOpen* remains insignificant in models that remove our political and institutional variables of interest—so it is not the case that our hypotheses cannibalize a significant *CapAcctOpen* relationship to inclusion due to collinearity.

Testing Foreign Currency Bond Index Inclusion

We then run the same series of models in the foreign currency index context. We expect that the four political, institutional, and policy variables associated with inclusion in the domestic index are not systematically associated with inclusion in the foreign index. We expect this because JPM does not scrutinize individual countries and bonds for entry into its mechanical foreign currency index in the same way that it does for its domestic currency index.

JPM's foreign currency index began in 1993, so we begin the sample in 1992. We run the same sequence of models as above using inclusion in the foreign currency EMBIG index as the dependent variable. The first stages of selection models use the issuance of any foreign bond as the outcome and replace the control of non-domestic currency bond debt with a measure of non-foreign currency bond debt.

Table 3 reports estimations. Interest is in the performance of the variables significantly associated with domestic index inclusion in Table 2. Results show that the political, institutional, and policy factors that inform JPM's domestic index inclusion decisions are *not* systematically associated with inclusion in JPM's foreign index. Stronger rule of law and transparency do not make foreign index inclusion more likely. Left governments and pegged exchange rates do not make foreign index inclusion less likely. Similarly, the macroeconomic controls significant in Table 2 are sometimes but not consistently significant in Table 3. Comparing Tables 2 and 3 shows borrower features affect inclusion in domestic currency but not foreign currency bench-

Table 2. Models of domestic currency index inclusion.

Model	Probit		Two-stage probit		
Model #	1	2	3	4	5
Left	−1.387***	−1.123***	−1.284***	−1.092***	−1.023***
	(0.467)	(0.231)	(0.462)	(0.234)	(0.242)
Law	2.249**	1.468**	1.717**	1.127*	1.096*
	(0.896)	(0.621)	(0.822)	(0.621)	(0.655)
GovtTransparency	2.468***	1.837***	2.028**	1.497**	1.455**
	(0.609)	(0.532)	(0.850)	(0.623)	(0.659)
Peg	−0.912**	−0.592*	−1.271***	−1.009***	−1.020***
	(0.375)	(0.322)	(0.430)	(0.382)	(0.371)
LaggedDV		3.401***		3.209***	3.230***
		(0.372)		(0.379)	(0.384)
GDPpcap	−0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
GDPgrowth	−0.023	−0.002	−0.018	−0.003	−0.002
	(0.022)	(0.022)	(0.021)	(0.022)	(0.021)
Inflation	0.016	0.010	0.008	0.007	0.002
	(0.021)	(0.018)	(0.024)	(0.022)	(0.022)
Reserves_PerTotDebt	−0.009***	−0.003*	−0.007**	−0.003	−0.001
	(0.003)	(0.002)	(0.003)	(0.002)	(0.001)
ExtDebtStock	−0.053***	−0.021**	−0.051***	−0.021**	−0.019***
	(0.011)	(0.008)	(0.011)	(0.008)	(0.007)
CreditRating	0.275***	0.126**	0.196**	0.087	
	(0.084)	(0.062)	(0.091)	(0.064)	
FinancialDepth	1.982***	0.314	1.901***	0.319	0.428*
	(0.502)	(0.399)	(0.504)	(0.403)	(0.221)
AnyDefaultLast2yrs	−0.018	−0.051	0.124	0.046	−0.081
	(0.301)	(0.245)	(0.298)	(0.233)	(0.228)
CapAcctOpen	−0.227	−0.517	−0.076	−0.416	−0.285
	(0.516)	(0.392)	(0.501)	(0.397)	(0.397)
CBI	1.446	0.042	1.504	0.033	
	(1.402)	(1.003)	(1.308)	(0.970)	
ΔUSRates	−0.110	−0.275	−0.089	−0.257	−0.213
	(0.111)	(0.216)	(0.115)	(0.200)	(0.198)
N (eligible country-years)	810	810	752	752	753
Selected *N* (issued any domestic-denominated bond)	NA	NA	613	613	614
First-stage Wald test			2.98*	2.95*	3.78*

Notes: All variables lagged 1 year. Cluster-robust standard errors. $*P < .1$, $**P < .05$, $***P < .01$.

mark indexes. Figures 5 and 6 present coefficient plots to visually summarize this comparison.

Substantive Significance

Since probit coefficients are difficult to interpret beyond sign and significance, we calculate and plot average predicted probabilities to interpret substantive significance. Figure 7 shows predicted probabilities are significant in the expected direction (estimation table reported in Online Appendix E for space). The strongest effects are in Models 1 and 3, which do not include lagged dependent variables. For example, in Model 3 (a two-stage selection model), a one-unit increase in rule of law and transparency makes EMs 22 and 26 percent more likely to be included, respectively. The dummy variables left governments and pegged regimes make EMs 17 and 16 percent less likely to be included, respectively. The predicted probabilities for the dummy variables may be interpreted as somewhat weak, but they remain significant, and the core point is that these are significantly associated with inclusion in the domestic index but not the foreign index.

Domestic Index Inclusion Effects on Market Access

Finally, we confirm the effects of domestic currency index inclusion on EM market access. Previous studies show that inclusion in JPM's foreign currency bond index relaxes the constraining effect of country-specific features on an EM's ability to issue foreign-denominated bonds (Cormier and Naqvi 2023). Below, we test if the same effect exists with the domestic currency index. When an EM is included in the domestic currency index, do they issue more domestic currency bonds regardless of their country-specific features? We are specifically interested in whether the factors that inform JPM's initial inclusion decisions also ulti-

Table 3. Models of foreign currency index inclusion.

Model	Probit		Two-stage probit		
Model #	6	7	8	9	10
Left	0.072	0.174	−0.435*	−0.195	−0.186
	(0.193)	(0.157)	(0.238)	(0.296)	(0.270)
Law	−0.255	−0.426	−1.130	−1.296	−0.880
	(0.602)	(0.323)	(0.759)	(0.885)	(1.189)
GovtTransparency	1.116***	0.235	0.778	−0.461	−0.346
	(0.335)	(0.236)	(0.518)	(0.538)	(0.640)
Peg	−0.566	−0.251	−1.812***	−1.645**	−1.226
	(0.370)	(0.237)	(0.557)	(0.786)	(0.900)
LaggedDV		3.620***		3.383***	3.571***
		(0.204)		(0.628)	(0.412)
GDPpcap	0.000	0.000	0.000	−0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
GDPgrowth	−0.007	0.014	0.017	0.047	0.048
	(0.020)	(0.024)	(0.027)	(0.046)	(0.059)
Inflation	0.002	−0.001	0.017	0.001	−0.007
	(0.005)	(0.003)	(0.011)	(0.019)	(0.016)
Reserves_PerTotDebt	−0.003**	−0.004***	0.002	−0.003	−0.003
	(0.002)	(0.001)	(0.003)	(0.006)	(0.004)
ExtDebtStock	−0.004	−0.006**	0.004	−0.009	−0.012*
	(0.003)	(0.003)	(0.005)	(0.007)	(0.007)
CreditRating	0.182***	0.099***	0.228***	0.139**	
	(0.044)	(0.027)	(0.054)	(0.060)	
FinancialDepth	−0.589	−0.860**	−0.464	−0.903	−0.295
	(0.481)	(0.417)	(0.601)	(0.677)	(0.563)
AnyDefaultLast2yrs	0.175	0.171	0.310	0.108	0.026
	(0.273)	(0.224)	(0.476)	(0.464)	(0.471)
CapAcctOpen	−0.550	−0.107	−0.573	−0.098	−0.139
	(0.356)	(0.244)	(0.452)	(0.455)	(0.423)
CBI	−0.226	−0.161	−1.724**	−1.161	
	(0.675)	(0.447)	(0.812)	(0.711)	
ΔUSRates	−0.021	−0.062	−0.060	−0.280	−0.247
	(0.042)	(0.149)	(0.109)	(0.238)	(0.252)
N (eligible country-years)	970	970	951	951	951
Selected *N* (issued any foreign-denominated bond)	NA	NA	365	365	365
First-stage Wald test			2.77*	0.09	0.00

Notes: All variables lagged 1 year. Cluster-robust standard errors. $*P < .1$, $**P < .05$, $***P < .01$.

mately constrain excluded EM domestic currency bond issuance, but no longer constrain EMs that have gained entry.

We find this is the case. Partisanship, rule of law, transparency, and pegs do not have the expected relationship with how much domestic currency bond debt an EM issues if the EM has entered the index—but they do have the expected constraining effect on domestic currency issuance by excluded EMs. This has two implications. First, it reinforces our argument that index constraints on market access are concentrated on initial inclusion decisions. Once an EM enters the index, market access is no longer shaped by the country-specific features on which index entry depended. Second, post-inclusion improvement in market access reifies why index providers carefully curate a low-risk subset of EMs to be included in the domestic currency index. Since domestic-denominated bonds are riskier for investors than foreign-denominated bonds, and index inclusion improves an EM's ability to issue more domestic-denominated bonds, initial entry to the domestic index is more carefully managed than the foreign index.

Data and Models

The dependent variable is the percentage of domestic currency bonds an EM government issues each year, vis-à-vis foreign currency bonds (data from Ballard-Rosa et al. 2022). This measures the degree to which EMs use domestic currency rather than foreign currency bonds to meet annual bond-based borrowing requirements. Online Appendix D reports descriptive statistics and plots the value of this measure over time.

$$DV = \frac{LocalCurrencyBondAmount\_USD}{(LocalCurrencyBondAmount\_USD + ForeignCurrencyBondAmount\_USD)}.$$

We use a fractional probit model including a lagged dependent variable with all covariates from the fully specified models in Tables 2 and 3. We also add interest rate controls (Jafarov et al. 2020) as a form of financial repression that may directly affect domestic currency bond issuance. All covariates are lagged. Standard errors are clustered on country.

Our main interest is whether the country-specific features that we find systematically inform JPM domestic index inclusion decisions affect EM access to, or use of, the domes-

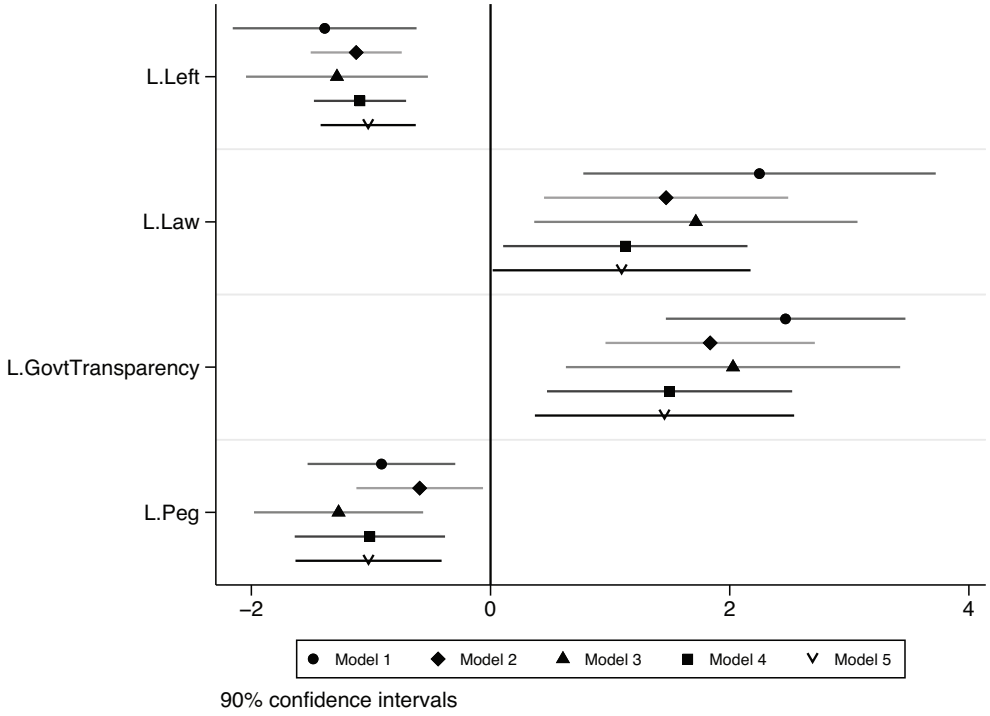

Figure 5. Local currency index inclusion coefficient plot (Table 2)

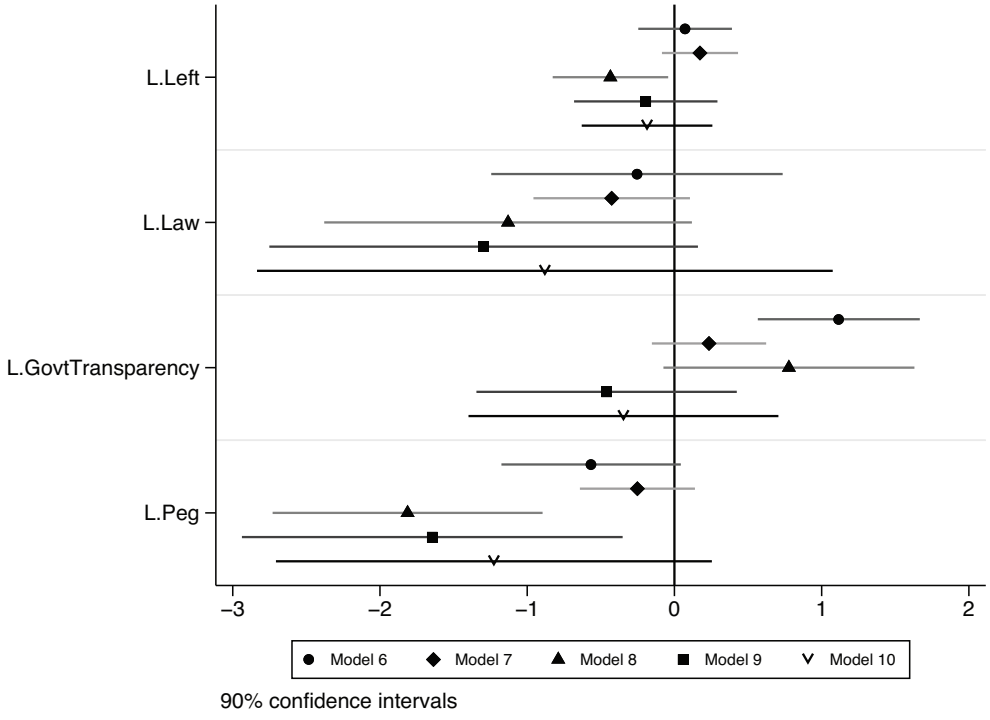

Figure 6. Foreign currency index inclusion coefficient plot (Table 3)

tic currency bond market after an EM is included in the index. To test for this, we interact *Left*, *Law*, *GovtTransparency*, and *Peg* with a dummy for whether the EM was included in the domestic currency index that year (*Inclusion*). This approach allows us to contrast the effect of country-specific features on the currency of bonds issued between included and excluded countries (this follows Cormier and Naqvi 2023, 1508–10). Where *Inclusion* = 0, we are identifying the relationship between a variable and bond issuance for EMs excluded from the index. Where *Inclusion* = 1, we are identifying the relationship between a variable and bond issuance for EMs included in the index.

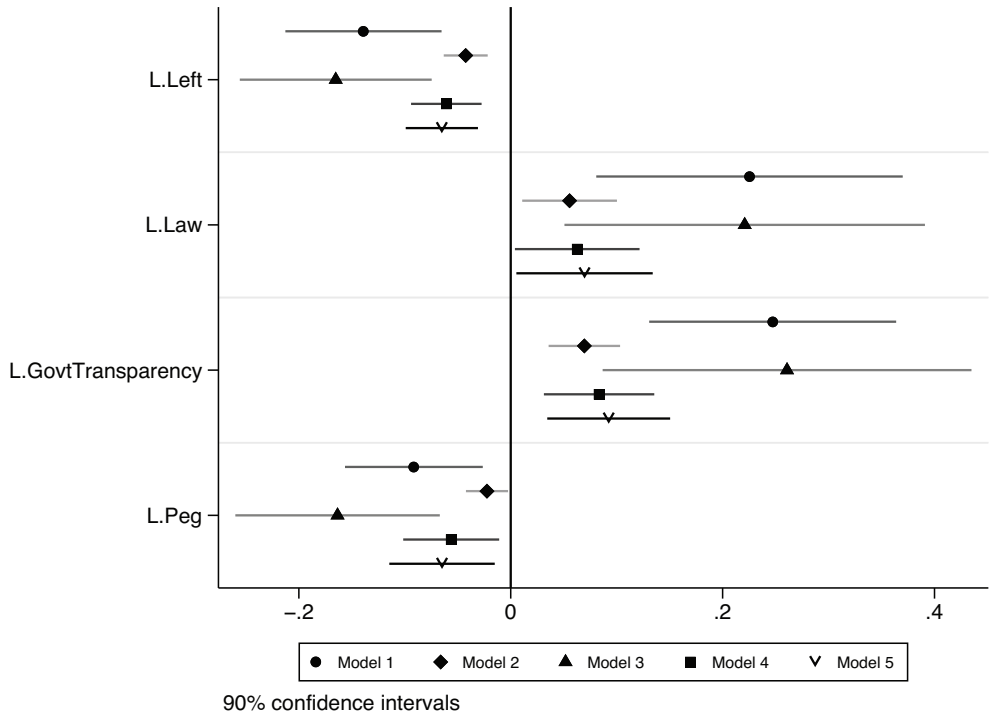

Figure 7. Predicted probabilities (Table 2)

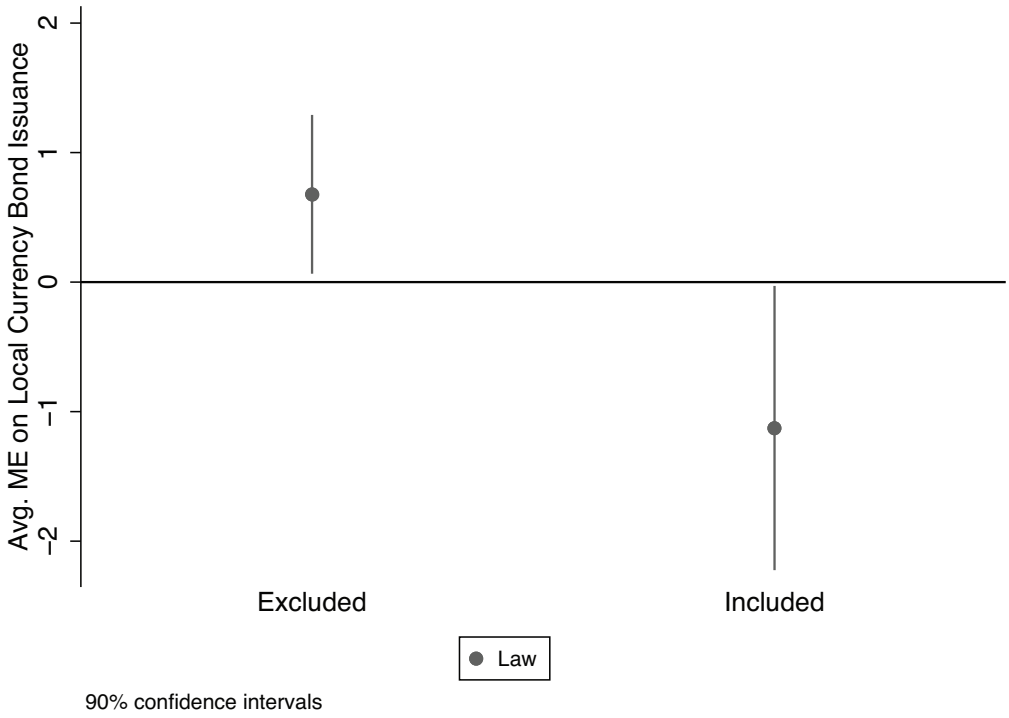

Figure 8. Average marginal effects of interacted law (Table 4)

Results

In Table 4, Model 11 is a simple correlation confirming that index inclusion increases use of domestic currency bonds on its own terms. Model 12 then estimates the full model, interacting *Inclusion* with our four variables of interest. Figure 8–11 plot the average marginal effects for each interaction. For excluded EMs, all four variables are associated with constraining effects on use of domestic currency bonds in the expected direction. Left governments and pegs make EMs likely to issue less domestic currency debt. Countries with stronger rule of law and transparency are likely to use more

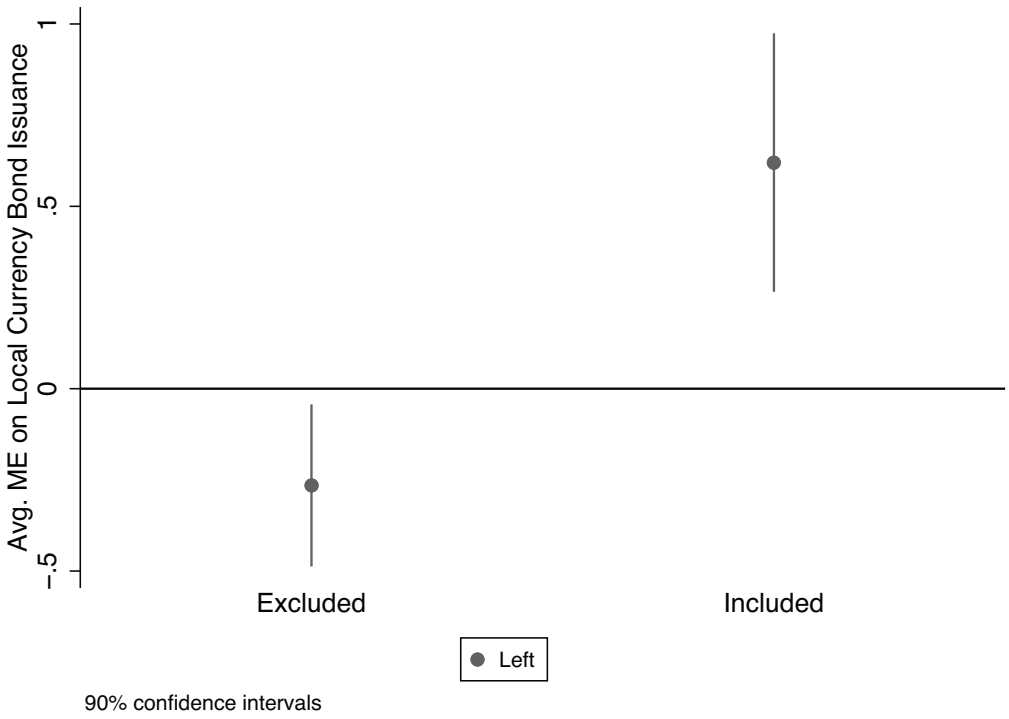

Figure 9. Average marginal effects of interacted left (Table 4)

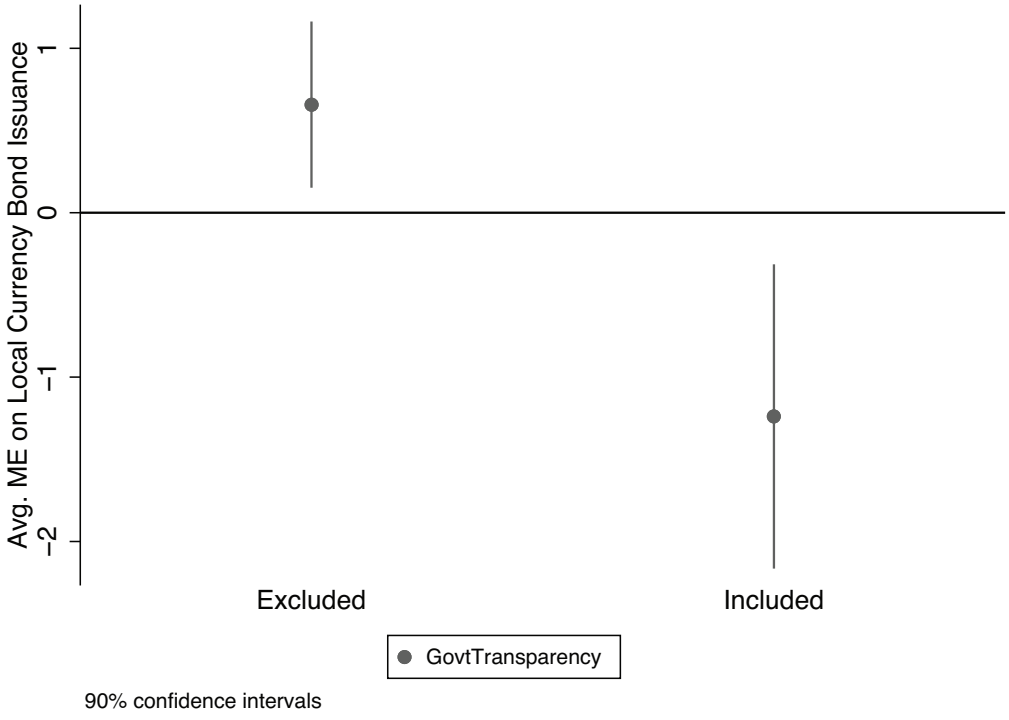

Figure 10. Average marginal effects of interacted transparency (Table 4)

domestic currency debt. Yet for EMs included in the domestic currency index, these variables do not have such constraining effects.

It is notable that the average marginal effect of each variable for included EMs is not insignificant, but significant in the opposite direction than what disciplinary theory would expect. This may be a signal that index inclusion grants EMs policy space to borrow in ways that counter disciplinary expectations: included EMs with left governments and currency pegs may indeed issue more domestic bonds, while included EMs with weak rule of law and transparency may be more likely to do so as well (i.e., the inverse of the relationship in respective fig. 8 panels). This would be an overly strong claim that we cannot make here. We can only say

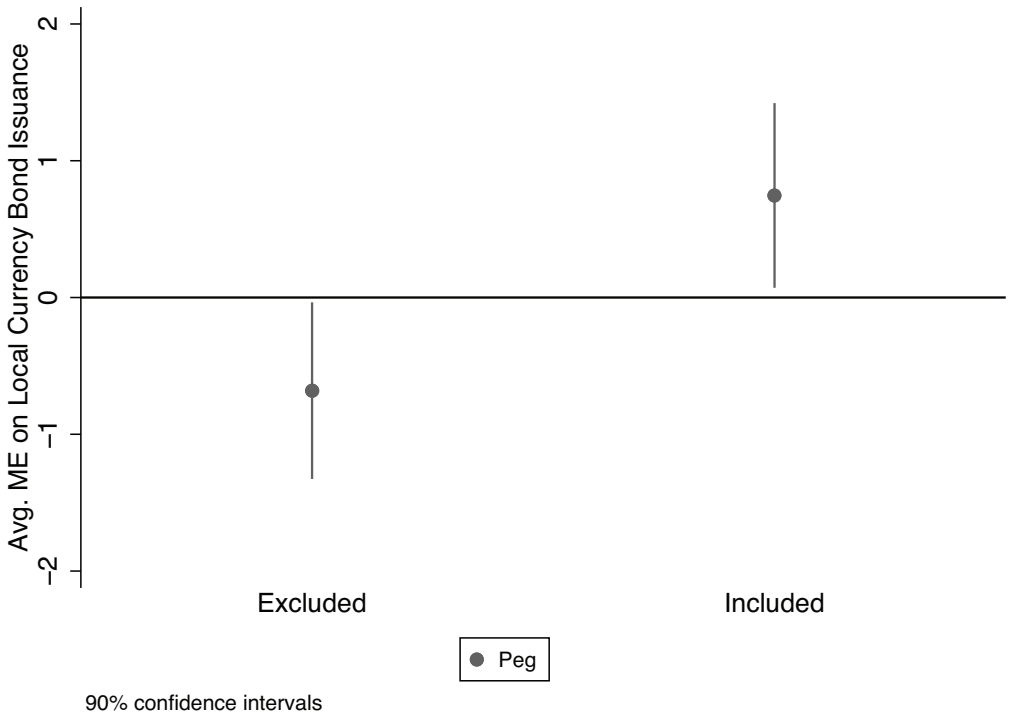

Figure 11. Average marginal effects of interacted peg (Table 4)

that index inclusion *changes* the degree to which EM use of domestic currency bonds is constrained by EM-specific features: excluded EM use of domestic-denominated bonds is constrained by key political, institutional, and policy characteristics, but included EMs do not face the same constraints. Full treatment of government responses to index inclusion is a topic we note for further research in the conclusion.

Appendix and Robustness Checks

Online Appendix D lists descriptive statistics. Online Appendix F reports first-stage estimations for the two-stage selection models. Online Appendix G checks robustness to alternative data choices and specifications. We replace rule of law with a general democracy measure, add legal borrowing privileges to confirm regulations around government borrowing do not affect findings (Betz and Pond 2025), add interest rate controls to check whether repressed domestic financial markets affect the above relationships (Jafarov et al. 2020), and add data on DMO autonomy to check robustness of findings as well as independent effects of varied debt legislation (Sadeh and Rubinson 2024). Significant observation loss when using these datasets relegates these models to the Online Appendix. Online Appendix H estimates models without lags. Inferences remain consistent.

We also estimate and discuss models other than probit functions. Online Appendix I estimates a multinomial model comparing inclusion in only the foreign index vis-à-vis inclusion in both the domestic and foreign index. Online Appendix J estimates ordinal logit models identifying initial entry into and removal from GBI-EM. Online Appendix K estimates Ordinary Least Squares (OLS) models. Online Appendix L estimates a Tobit model matching Model 12 in Table 4. Online Appendix M probes pegs and exchange rate volatility further. Results support the inferences made above.

Conclusion

Indexes govern access to vast pools of capital in EM sovereign bond markets. Inclusion in bond indexes, then, is a key determinant of market access for EM governments. But not all indexes are designed the same. We argue and find that variation in index design yields variation in how politics, institutions, and policy choices affect index inclusion and subsequent market access.

Two key implications arise. First, index providers are gatekeepers with varied inclusion requirements in domestic versus foreign currency indexes and thus varied implications for understanding EM access to each market. Given the scale and effect of index investment, the study signals the importance of shifting scholarly attention toward these contemporary actors and investment practices that affect flows as much as disaggregated market signals. We provide theoretical and empirical material on which to build such research, including historical index data.

Second, market access depends on different borrower features in foreign versus domestic currency markets. Index inclusion is a more difficult hurdle to clear in the domestic context than it is in the foreign context. Moreover, countries included in indexes are less constrained by political-economic features than excluded EMs. This provides a more nuanced picture of how financial markets do and do not constrain borrowing sovereigns in the contemporary era of financial globalization (see also Cormier and Naqvi 2023; Cunha 2024; Mosley 2003). Future work can advance the field by further parsing the detailed ways in which market access varies across different markets. Moreover, we do not assess responses to index-dictated market access by borrowing EMs. Do included EMs make different policy choices than excluded EMs insofar as enhanced market access implies increased policy space? Answering such questions would advance our understanding of whether and how governments

Table 4. Models of domestic currency index effects on market access.

Model #	11	12
Included	0.371*	2.110
	(0.206)	(1.315)
Left		−0.265**
		(0.135)
Left × included		0.620***
		(0.215)
Law		0.678*
		(0.373)
Law × included		−1.127*
		(0.667)
GovtTransparency		0.658**
		(0.307)
GovtTransparency × included		−1.239**
		(0.563)
Peg		−0.681*
		(0.393)
Peg × included		0.746*
		(0.410)
LaggedDV		1.356***
		(0.252)
GDPpcap		−0.000
		(0.000)
GDPgrowth		0.039***
		(0.014)
Inflation		−0.008
		(0.008)
Reserves_PerTotDebt		0.003*
		(0.002)
ExtDebtStock		−0.005**
		(0.002)
CrediRating		−0.001
		(0.029)
FinancialDepth		0.251
		(0.223)
AnyDefaultLast2yrs		−0.493***
		(0.168)
CapAcctOpen		−0.254
		(0.231)
CBI		−1.334***
		(0.364)
IntRateCntrls		0.145*
		(0.088)
ΔUSRates	−0.012	−0.019
	(0.064)	(0.137)
N	968	529

Notes: Cluster-robust standard errors. $*P < .1$, $**P < .05$, $***P < .01$.

respond to an era of financial globalization driven by index investment.

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Supplementary material

Supplementary material is available at *International Studies Quarterly* online.

Data availability

Data and replication materials available on the ISQ Dataverse at https://dataverse.harvard.edu/dataverse/isq.

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