

Looking Beyond the Debt Accumulation

A Critical Assessment of the Causal Mechanisms behind a Global Debt Crisis

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This thesis aims to offer a critical analysis of the phenomenon of a global debt crisis and possible mechanisms that may cause them. It starts with a hypothesis that the concept of a global debt crisis is too vaguely defined and relies too much on the idea of excessive debt being the root cause of the crisis. Instead, the thesis will argue that a global debt crisis must have a systemic nature where the crisis threatens the existence of the entire global monetary system. For the purposes of the argument, the different interpretations of debt are examined, the relevant features of our global monetary system are determined, and a systemic crisis theory of Jürgen Habermas is utilized.

The thesis has its theoretical background in Critical Realism, which will help distinguish social mechanisms with real causal powers that may contribute to forming a global debt crisis. The thesis uses abductive and retroductive reasoning to assess different mechanisms brought forward in the relevant literature of whether they are capable and necessary to cause a global debt crisis. Furthermore, the thesis will approach the debt from the perspective of Modern Monetary Theory (MMT), which emphasizes the state's role in managing money and debt relations. Specifically, the thesis will apply the frameworks of sectoral balances and monetary sovereignty to determine the differences of the global debt network in contrast to sovereign or private debt. Based on these frameworks, the argument is that the same mechanisms cannot cause a global debt crisis as a sovereign debt crisis.

In the analysis part, the thesis focuses on two possible mechanisms that frequently appear in the academic literature as a cause for a global debt crisis: global imbalances and global debt deflation. The case for global imbalances relies on the fears of the U.S. dollar collapsing, which the frameworks of MMT indicate to be highly implausible due to the total U.S. monetary sovereignty. On the other hand, the case for global debt deflation rests on an increasing accumulation of private debt, which is shown to be more dangerous globally. However, despite its sound systemic causal mechanism, the assessment finds that global debt deflation is alone an insufficient cause to create a global debt crisis.

In conclusion, the thesis emphasizes the role and significance of political decisions as a necessary cause behind most debt crises, especially a possible global one. The relevance of debt-controlling institutions are considered briefly, but the ultimate responsibility for preventing a global debt crisis is put into the hands of currency-issuing states. Political decisions will be shown to function as both a capable and necessary cause for a global crisis. Furthermore, the thesis also considers the limitations of using MMT to examine global debt relations and gives preliminary suggestions for further research.

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1. INTRODUCTION

1.1. PROBLEM WITH A GLOBAL DEBT CRISIS

We live in a golden age of accruing debt. Institute of International Finance (IIF) estimated in the summer of 2021 that due to the massive public spending during the COVID-19 pandemic, global debt levels have reached an all-time high of more than three and a half times the global GDP and nearly 300 trillion dollars in total¹ (Tiftik and Mahmood 2021).

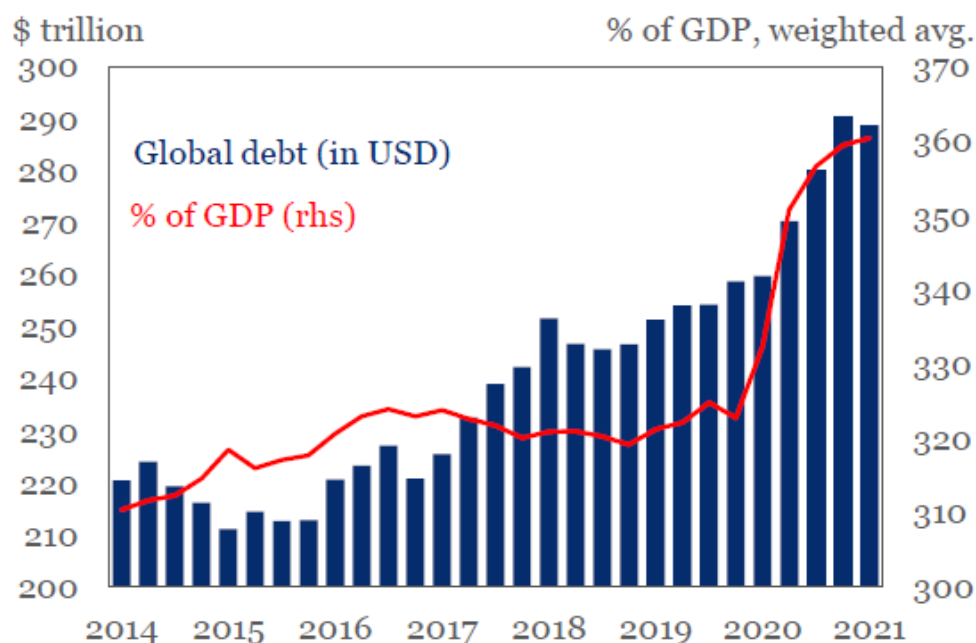


Figure 1. Global debt levels in total and % of GDP, 2014-2021 (Tiftik and Mahmood 2021).

A year earlier, World Bank had published a report called *Global Waves of Debt: Causes and Consequences* (Kose et al. 2020), which issued a stark warning against rising global levels of debt. According to the report, the world has lived through three previous waves of debt since

¹ These estimations combine the debts of both public and private sectors. Debt owed by governments (sovereign debts) is approximately third of this, amounting to slightly more than the global GDP (106%) and about 83 trillion in total, according to the IIF. We will repeatedly stress the differences between public and private debt during this thesis.

the 1970s,² and that we are currently in the midst of a fourth wave that is the first truly global one. What makes this wave especially dangerous, the report argues, is that whereas the previous waves were limited to only one region or economic sector, the current wave encompasses both the private and public sector and has raised debt levels everywhere in the world (ibid., 113). These debt levels are most concerning for emerging markets and developing economies (EMDEs) since they usually have riskier funding sources and are most susceptible to the confidence of global markets. For these reasons, the World Bank report strongly advised countries to take this ongoing global crisis seriously and implement necessary measures to mitigate its effects.

In the academic literature, warnings of a future global debt crisis have emerged from time to time (e.g. Pettifor 2006; Rabie 2017), but the debt crises discussion has usually revolved around sovereign or regional problems, such as Latin America in the 1980s or Southern Europe in the 2010s. However, the response to the Covid-19 pandemic has led to an unprecedented rise in public deficits worldwide, a development that has increased the total debt to levels many deem dangerous in the long run.³ Accordingly, commentators in newspapers (Stiglitz and Rashid 2020), in political magazines (Eichengreen 2020; Moyo 2020), and, naturally, in global monitoring institutions such as the International Monetary Fund (IMF) (Okamoto 2020), have warned against the coming global debt crisis. The standard argument in these warnings is that debt levels have become ever more unsustainable in recent years, meaning that many countries are in danger of not being able to service their debts anymore. The worst-case scenario would be a global wave of defaults, widespread economic disorder, and, eventually, a full-scale global debt crisis. As Stiglitz and Rashid argue:

“From Latin America’s lost decade in the 1980s to the more recent Greek crisis, there are plenty of painful reminders of what happens when countries cannot service their debts. A global debt crisis today will push millions of people into unemployment and fuel instability and violence around the world.” (Stiglitz and Rashid 2020)

² The first wave was the heavy borrowing by low-income countries in the 1970s and early 1980s. The second wave followed the liberalization of capital markets in the 1990s and centralized mainly with banks and governments in Europe and East Asia. The third wave was the vast private sector borrowing in the Anglo-American world ahead of the Global Financial Crisis (GFC) of 2008. The report argues that all previous waves led to a severe financial crisis in respective sectors and regions (Kose et al. 2020, 58-59).

³ At the time of writing, the Covid-19 pandemic is still ongoing, so there is no systematic study of its long-term economic effects yet published. Few preliminary analyses examining the effects of the pandemic for global debt (Munevar 2021; Ozili 2021) follow broadly the warnings of the World Bank report where growing levels of debt dramatically increase the risk of crisis or even automatically lead to one.

Another more academic warning has presented our current situation in the following terms:

“Today, most nations face mountains of debt and huge budget deficits that hinder their abilities to grow their economies, create jobs for the unemployed, and help their needy and university students burdened by debt. As a consequence, poverty and unemployment rates remain high in most countries, and a sense of hopelessness and helplessness overwhelms a majority of people in many parts of the world. Since the debt problem is not limited to ten or twenty states, it must be viewed as a global issue.”
(Rabie, 2017, 24)

How should we interpret these warnings of rising debt levels? For many commentators, it seems evident that a global debt crisis is already upon us or, at the minimum, we are rapidly approaching one. I certainly do not wish to downplay the severe effects of sovereign debt crises that have been well documented and proved to be economically devastating for governments and citizens alike.⁴ However, the case for the coming **global** debt crisis is full of ambiguities and unsound assumptions. There is something in common with all these academic and journalistic texts dealing with the global debt and, simultaneously, something missing. On the one hand, they all seem to have a shared assumption that high debt levels worldwide are dangerous in themselves. On the other hand, they rarely present any credible mechanism for how the global crisis could develop from lower-level origins, such as the sovereign debt crisis. Even worse, these warnings rarely clarify the necessary properties of a global debt crisis at all. Instead, they often leave us with banal catchphrases such as “Piling debt on top of debt seems to have reached a dead end.” (Moyo 2020).

Being a harbinger of impending economic doom is easy and attracts listeners. For example, Marxists argued for decades that the capitalist system was heading into an inevitable disaster because of the falling rate of profit, among other reasons (Boldizzoni 2020). Instead, global capitalism survived all of these forecasts and has become the only dominant economic system on the planet. Therefore, people should have a healthy distrust against all forecasts that paint the picture of an inevitable global crisis, at least if they do it without making a solid case for how such a crisis could materialize. Without that, there is a danger that crisis is used simply as a rhetorical tool to remove economic decisions from the democratic process and keep the

⁴ An enormous field of literature focuses on both European and Latin American sovereign debt crisis and their economic and social effects. A good summary from the European perspective is (Varoufakis 2017); for the Latin American crisis, a classical account is (Griffith-Jones and Sunkel 1986). Unfortunately, a broader discussion of these events is outside the scope of this thesis, but we will come back to the mechanisms of a sovereign debt crisis in chapter 5.1.

existing power structure in place, as happened in the years after the Global Financial Crisis of 2007-2009 (GFC)⁵ (Mirowski 2014). Another possibility is that a debt crisis is in danger of becoming “an empty signifier”, a concept devoid of all shared meaning that can refer to almost anything depending on the user.⁶ This thesis does not contribute to the inflation of the term global debt crisis and attempts to keep it for meaning something precise and practical.

Due to extensive research over the decades, mechanisms and causes of sovereign debt crises have become relatively well studied and understood (e.g. Reinhart and Rogoff 2011; Stiglitz and Heymann 2014; Guzman et al. 2016). A simplified mechanism is a straightforward sequence of events where governments cannot service their external debts, leading to widespread economic problems. In the case of the sovereign (and private) debt crisis, countries with a disadvantageous position in global economic order can easily be left at their creditors' mercy, especially if their debts are denominated in foreign currencies. However, almost all articles and studies that mention the coming global debt crisis merely apply this same reasoning to the global level without considering whether it is feasible.

When examining any economic phenomenon on the different levels of society, there is a risk for the fallacy of composition, meaning that something that is true on the part of a whole is also assumed to be true on the entire whole. A classic example of this is the so-called paradox of saving in Keynesian economics.⁷ Keynes argued that even though everyone considers saving to be beneficial for their personal income, if everyone chooses to save simultaneously, that would decrease the aggregate demand leading to adverse economic effects on the societal level (Keynes 1997 [1937], 87). What is possible for one or some is not possible for all. Following this principle, we can similarly argue that what is harmful to individuals is not necessarily harmful to the system; indeed, it might be obligatory for the system to survive.⁸ One of the hypotheses for this thesis is that global debt is a topic susceptible to the fallacy of composition. Statements about the harmful effects of debt that are relevant on the private or national level

⁵ Referring to the years 2007-2010, the term Great Recession is also widely used, but this thesis applies a more narrow term of GFC because it combines better with its crisis-focused approach.

⁶ The concept of an empty signifier is used extensively by Critical theorists for various applications of discourse analysis. Some proposed empty signifiers include concepts such as race, governance, sustainability, structural reform or even Princess Diana. One famous study of how empty signifiers have become necessary tools for populists is (Laclau 2005).

⁷ Various versions of the paradox of saving (or the paradox of thrift) have been traced back to Biblical times, but it was not popularized in economics until Keynes.

⁸ For example, Marxists argue that a classic case is unemployment, which brings problems to an individual but is necessary for the capitalist system since it provides an employment reserve that helps keep wages low and profit margins high.

are not necessarily relevant globally. Therefore, claims that a global debt crisis will necessarily follow from multiple sovereign debt crises or even from a severe regional debt crisis are examples of the fallacy of composition.

Moreover, the warnings of a global debt crisis seem misguided because they usually use the word ‘global’ as a substitute for ‘international’. One of the basic principles of Global Politics and Global Political Economy (GPE) is that the state-centric approach is too limited and that international relations are just one aspect of our global system.⁹ The field of GPE looks to the world as an interconnected system of private and public power encompassing the entire world (Ravenhill 2017, 20). A crisis that affects many countries simultaneously is by definition an international one, but not necessarily a global one. Using “global” to refer to the world system rather than any arbitrarily chosen set of countries will save us from unnecessary confusion. This approach also emphasizes the fact that global and national monetary systems differ in many crucial respects, as we will see later in the thesis. Therefore, this thesis starts from the assumption that **a global debt crisis must threaten the functioning of the entire global system**. Since debt is a monetary phenomenon, the global system in question must also be the monetary system. Therefore, thinking about global debt requires an explicit explanation of the inner functions of the global system and possible mechanisms that may affect it.

The approach of this thesis towards the global debt largely follows the Modern Monetary Theory (MMT) framework, which will be a subject of chapter 4. Despite a heavy critique towards some of its policy recommendations, MMT is establishing its place as an insightful theory about the state's role in money creation, among other things. One of the primary purposes of the MMT is to correct multiple misconceptions we have about the inner functions of currencies and debt (Mitchell et al. 2019), making it a valuable tool for my approach to global debt. However, when it comes to the political side of the theory, we need also be aware of its limitations. The positive side of MMT is that it has given us several new ways to consider national budgets, deficits, and increasing debt levels. On the other hand, its downside is that MMT is still mostly applicable to just monetary sovereign nations, limiting its usefulness when discussing global issues.

⁹ This is the exact reason why the discipline of International Relations (IR) has been renamed in many universities as World Politics, Global Politics, Global Studies, or something similar. On the limitations of the “international” approach in general, see (Acharya 2014).

In this Introduction, I have attempted to summarize my hypothesis: reasons and mechanisms for global system-level debt crisis do not necessarily correspond to the mechanisms that cause a private and sovereign debt crisis. Indeed, we will argue they cannot be the same exact mechanisms for the reasons examined in the following chapters. The main reason is that, following the principles of MMT, debt is an indispensable feature of global monetary relations which means that its existence alone cannot be a cause for a global debt crisis.

This thesis has two overlapping goals or research questions. The first one is to clarify **why** the unfolding of a global debt crisis cannot follow the same trajectory as the other types of debt crises and cannot be a product of the same mechanisms. The second one is to analyze **what mechanisms** might be capable of producing a global debt crisis and for what reasons. The purpose is both to be critical of the prevalent views and open for explanations that fit better in our politico-economical reality. Thus, this thesis aims to contribute to the social scientific knowledge by not making inferences from any predetermined data but by asking relevant research questions and assessing the possible answers with appropriate social scientific tools, as the principles of Critical Realism (CR) recommend (Sayer 2010, 241-251). Naturally, we need to acknowledge that while tackling a hugely complicated topic of a global debt crisis, this thesis can cover just a part of the issue. Nevertheless, that does not mean it cannot offer some often overlooked viewpoints for further debate.

1.2. RELEVANCE TO THE GPE

Despite its essential role in the world economy, global debt is a relatively understudied topic in the GPE-context. When questions of excessive debt emerge in the academic literature and general discussion, scholars have either focused on the sovereign/regional level or examined debt as a side effect of other economic problems such as banking or currency crises. For example, the prevailing narrative around the European sovereign debt crisis (the Euro Crisis) that started in 2009 sees the events as a direct continuation of the American housing market bubble and the following banking crisis a year before (Tooze 2018). In the true GPE-fashion, high debt levels in Europe were just one aspect of a more holistic and interconnected global crisis. Unfortunately, this approach has made it more challenging to study global debt relations as a separate phenomenon and differentiate between debt crises and other types of financial crises.

At least since the 1980s, the political nature of sovereign debt has been recognized among some economists and practitioners (Strange 1998). For example, many developmental economists have emphasized the role of political relations between debtor and creditor nations and advocated extensive debt relief measures to prevent human suffering.¹⁰ During the recent decade, there have been some calls to re-politicize the discussion around sovereign debt from the field of political economy (Hembruff 2013; Roos 2019). However, in GPE, there is still relatively little scholarly attention towards the global dynamics of debt, and the academic discussion concerning the global debt issues has been left primarily to the mainstream economists. For them, excessive debt is usually considered a symptom, a consequence of economic mismanagement, which countries must then manage by using sound budgeting and cutting unnecessary expenditures. A similar narrative has spread effortlessly into the language of fiscally conservative politicians, with significant real-world results.¹¹ Therefore, there is an overdue need for a critical GPE to offer a well-reasoned counternarrative for the global debt debate and bring politics back to the centre of the issue.

There is always a danger in GPE for an information overflow, which may lead to losing sight of what is relevant. Since our field tackles complex, interconnected questions, academics sometimes rely too much upon familiar metaphors and generally accepted consensus. Even though much of the thesis attempts to disturb this consensus by reconfiguring the concept of a global debt crisis, the other aim is to understand it as a social phenomenon with a material dimension that can produce causal effects in the real world. Thus, in addition to being theoretical in its approach, this thesis takes the mechanisms of the social world and historical argumentation seriously. Hopefully, by problematizing the current use of the concept of the global debt crisis and determining credible mechanisms that can constitute one, this thesis should contribute to the collective knowledge of GPE.

This thesis consists of eight parts, which should build the overall argument in a logical order. In this Introduction, I have presented my research problem and its relevance for GPE. In the second part, I will go through my theoretical and methodological choices and explain why Critical Realism offers the most sound framework for tackling the research questions. The third

¹⁰ The justification for relief proposals can take many different forms. Kunibert Raffer has given priority to legal arguments (Raffer 2001). Some others prioritize the effects of globalization (e.g. Pettifor and Bush 2003).

¹¹ See, for example, the controversial paper by Carmen Reinhart and Kenneth Rogoff that was widely discussed in the context of European sovereign debt and used as a guide of policymaking (Reinhart and Rogoff 2010). They determined the critical threshold of debt is 90% of the GDP, after which the debt starts to seriously hinder the economic growth in the developed countries. Their results have been later disputed, see (Herndon et.al. 2014).

part will break the concept of a global debt crisis into smaller parts and examine each one of them separately. By doing that, we aim to demystify the idea of debt, compare competing theories about the features of our global monetary system, and present a coherent and strict definition of a crisis applicable to the research questions. The fourth part presents a short overview of the MMT and argues why its principles offer new possibilities for understanding a global debt crisis while also considering its limitations. The fifth part briefly summarizes the mechanisms for a sovereign debt crisis and explains why they are insufficient to explain a global debt crisis. The sixth part will present the two credible mechanisms for the global debt crisis that have been warned against repeatedly in the relevant literature, global imbalances, and debt deflation, and assess their validity based on MMT principles and their approach to debt. In the seventh part, we will briefly discuss the importance of politics and institutions for the global debt issues. The eighth part offers a short conclusion and suggestions for further research.

2. THEORETICAL AND METHODOLOGICAL REFLECTIONS

There is a widespread habit in the human and social sciences to strictly divide the research methods into quantitative and qualitative approaches. Generally, the former aims to uncover statistically significant correlations from large datasets that one can present via mathematical models. In contrast, the latter seeks to understand more context-dependent phenomena mainly through various discourse analysis techniques to examine texts and language. Both approaches emphasize the importance of data gathering and forming a testable hypothesis from data. In the field of IR, some scholars have used the terms explaining and understanding international relations to differentiate between the research goals (Hollis and Smith 1990). This methodological divide brought some clarity into the discipline¹², but many schools of thought have criticized it for being too narrow and have constructed alternative methods for social scientific research. This section will briefly go through some of these alternative methods and explain why we should consider them the most appropriate for tackling the research questions.

¹² This is partly because humans (at least in Western culture) have a strong inherent tendency to think with opposition, even with things that do not really fall into two clear categories (Sayer 2010, 23). In politics, we see the same thing happening with left-right categorization, which has become ever more muddled in recent decades but still serves as a starting point of political analysis because we seem to be unable to abandon it.

2.1. CRITICAL REALIST APPROACH TO SOCIAL SCIENCE

Metatheoretically, the approach of this thesis towards global debt will follow the principles of Critical Realism (CR), first formulated by English philosopher Roy Bhaskar in the 1970s (Bhaskar 1975, 1979). CR emphasizes that even though our knowledge of the world is always fallible and theory-laden, it does not prevent a better understanding of real-world processes. Critical realism differs from, on the one hand, naively positivist approaches that claim that all knowledge arises from experience and, on the other hand, various post-structuralist approaches that deny the objective reality and focus on interpreting texts. For CR, reality exists as a stratified totality where both objects and structures can generate real effects on the different levels of explanation (Danermark et al. 2002, 59-61). However, these effects can give rise to new systemic properties that were not a property of any system component through a process called emergence (Hodgson 2000). For example, in the context of GPE, it allows us to see potential properties of global debt that are not reducible to any properties existing with national or private debt.

The central question for critical realists is to clarify what kind of properties different social systems possess that allow us to acquire knowledge of those systems (Bhaskar 1979, 31). Even though we may never get a complete picture of reality because of its enormous complexity, we will get closer to the truth with the rigorous and systematic scientific examination. However, the CR also acknowledges that social scientific structures differ from natural structures because they do not exist independently of the people's conceptions but are dependent on human activity that has created them (ibid., 48-49). This difference, combined with the notion of the open-ended nature of our social world, requires specific tools to make relevant claims about the said world.¹³

Due to the nature of the chosen research questions, this thesis cannot apply either quantitative or qualitative research tools straightforwardly. Instead, it follows a broader understanding of a method presented by Andrew Sayer in his *Method in Social Science: A Realist Approach*. (Sayer 2010), which follows the principles of Critical Realism. Sayer emphasizes proper conceptualization as a prerequisite for successful theoretical and methodological social

¹³ The scope of this thesis does not allow a complete discussion of the properties and applications of Critical Realism. The classical accounts are (Bhaskar 1975, 1979 and Collier 1994). In the overlapping fields of this thesis, namely economics and global politics, valuable contributions are (Lawson 1997) in economics and (Patomäki 2001) in global politics.

scientific research, and CR is known for its explicit commitment to conceptual clarity. Social phenomena are concept-dependent, so to truly understand their functioning, we need first a better grasp of their meaning (ibid., 30). This kind of social scientific self-awareness is just as important when thinking about large-scale phenomena, and it might even lead to fundamental alterations of basic concepts. As Sayer puts it: “These alterations require us to ‘explicate’ problematic concepts; that is, give concise definitions to important but vaguely understood terms through re-working their relations with other terms in the network” (ibid., 81). In other words, the conceptualization of social scientific terms seeks to identify structures and properties through rigorous and systematic examination and theorizing.

Furthermore, when considering broad and complex phenomena such as the global debt crisis, there is a high risk of being stuck with common misconceptions or misleading metaphors. As stated in the Introduction, one of the main aims of this thesis is to critique various misconceptions that we hold regarding global debt. However, the aim is not just to evaluate prevailing views critically but to offer a more coherent view for global debt issues, and in doing that, contribute to emancipatory knowledge (ibid., 40-42).¹⁴ Here we follow again Andrew Sayer, who has emphasized that: “To be practically adequate, knowledge must generate expectations about the world and about the results of our actions which are actually realized.” (ibid., 69). Debt crises are not purely theoretical conceptions one can examine unrelated to any social actualities. When they do emerge, they have genuine material and economic consequences that can be destructive for people and institutions alike.

2.2. CAUSAL POWERS, SOCIAL MECHANISMS, AND THE RETRODUCTIVE METHOD

“When activated, particular mechanisms produce effects in ‘conjunctures’, which may be unique. According to conditions, the same mechanism may sometimes produce different events, and conversely, the same type of event may have different causes. Abstract theory analyses objects in terms of their constitutive structures and in terms of

¹⁴ In that sense, my critique against the prevailing views of global debt issues comes close to immanent critique, which is a means of detecting societal contradictions that offer possibilities for emancipatory change (Antonio 1981). However, ultimately my goal remains somewhat different from the usually Marxist applications of immanent critique since I do not focus on contradictions in any major ideological system, such as capitalism.

their causal powers. Concrete research looks at what happens when these combine.”
(Sayer 2010, 116)

When examining social scientific phenomena, critical realists focus primarily on social mechanisms and causal powers, which are often intertwined, as Sayer demonstrates above. Argumentation of this thesis proceeds primarily at the abstract level since it evaluates explanations made for a supposed event, namely a global debt crisis. The aim is to examine what may constitute a global debt crisis, not what will happen if one strikes.

Unlike in many other social scientific fields, CR sees causal powers not as mere event regularities that correlate to one another but as real things that provide material results. These causal powers apply both events and immaterial forces such as ideas, norms, discourses, or ideologies. CR-theorists emphasize that causes always exist in open systems where multiple causal forces interact and counteract in complex ways (Kurki 2007). Thus, causality is an ontological fact, and we can identify causal relations in social sciences through careful reasoning.¹⁵ Causality is also a force independent of successful predictions; the aim is not to predict but to seek out the conditions and mechanisms required for something to happen (Sayer 2010, 110). In the context of a debt crisis, the task is to determine what preconditions we need to meet before declaring the situation a crisis.

Causal powers make things happen with different mechanisms that may be inherent in the underlying structure or come from external sources. In the case of social sciences, the mechanisms in question would need to have historical and social forms. In addition, the causal mechanisms often arise from the systemic tendencies that a particular social structure is producing. CR also emphasizes that inside an open system, a crisis may reveal some hidden mechanisms from the social structures that went previously unnoticed (*ibid.*, 128-129). In the context of the global economy, this could mean that some economic tendency, such as amassing of private debt, would suddenly start to produce adverse effects if the global situation changes markedly. However, when talking about a systemic feature such as debt, we should not accept just any causal effect as an appropriate mechanism since they might not tell us anything relevant about debt. In the case of debt, we can acquire more non-trivial knowledge if we focus on crisis-

¹⁵ For a more extensive discussion about the CR view towards causation and its advantages over other social scientific views, see (Kurki 2008).

leading mechanisms arising from the structure/system itself and its possible contradictions rather than from outside events.

As an example of external mechanisms, we can briefly examine Ann Pettifor's *The Coming First World Debt Crisis* (Pettifor 2006). In her book, Pettifor presents five potential 'debtonators' that could trigger the global economy to plunge into a downward spiral. These triggers are rapidly advancing climate change, sudden oil price hikes, housing market crash, collapsing US dollar, and falling consumption levels due to interest rate rise (ibid., 150-160).¹⁶ However, the shortcoming of these external shocks is that they do not consider the inner functioning of the global monetary system leaving the causal explanation of crisis insufficient. Claiming that climate change can lead to a global debt crisis tells us very little of the ways debt crisis will materialize, apart from the fact that it may lead to higher debt levels. As we established in the introduction, we need something less ambiguous to make a plausible argument about mechanisms. This thesis aims to complement Pettifor's 'debtonators' by examining systemic tendencies and the relations between different actors inside the system. Indeed, Pettifor herself (among others) has offered debt deflation as a much more plausible mechanism that we will come back to in Chapter 6.2.

The approach used to uncover what mechanisms can lead to a particular outcome is called 'retroduction', the closest thing this thesis has of a research method.¹⁷ To be more specific, retroduction is a method for identifying the circumstances without which some event or concept cannot exist (Meyer and Lunnay 2013). In other words, retroduction requires us to look for mechanisms that are both **capable of** and **necessary for** producing an event in question. Its shortcoming is that we can never make logically true statements using retroduction, but this is rarely the goal in social scientific research in any case. As Andrew Sayer has emphasized, relations between causal mechanisms and their effects are contingent. They do not form any scientific law, meaning we need to evaluate them case-by-case basis (Sayer 2010, 107). Using a mode of inference is simply to uncover the best possible explanation(s) for an event that one can defend against alternative explanations. Accordingly, if we want to identify the mechanisms

¹⁶ One of these triggers came to fruition with the US housing market crash of 2007-2008, which led to the prolonged financial crisis. However, the First World Debt Crisis Pettifor predicted has not materialized, at least not in a way her book describes it would happen.

¹⁷ This method was invented and first used by the pragmatist school of philosophy, especially Charles S. Peirce, and many other scholars have since adopted it in multiple different fields. Retroduction is closely related to another Peircean method of 'abduction', a mode of inference that strives for the best explanation. For the complementary relation between the terms, see (Ritz 2020).

capable of causing a global debt crisis, retroductive inference seems to be the most applicable method.

These theoretical and methodological positions make Critical Realism highly suitable for tackling the chosen research questions. Its methods differ from the widely used econometrical modelling, but, at the same time, they allow us to look into economic events as a subset of social scientific events, which they ultimately are. Practitioners of CR have long argued that methods such as reproduction are a way of “reorienting economics into social science” (Downward and Mearman 2007) and, thus, better reflect the interdisciplinary nature of the GPE. Furthermore, CR is committed to methodological pluralism, where researchers can apply and combine a different array of methods best suited for particular kinds of research questions (Danermark et al., 2002).

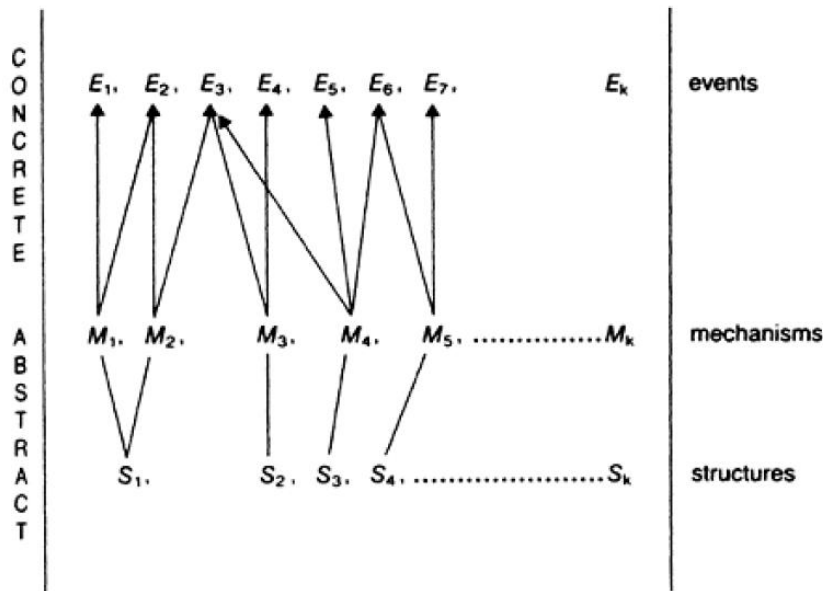


Figure 2. The causal chain between structures, mechanisms, and events in Critical realist methodology (Sayer 2010, 117).

To summarize the argument, the causal chain in CR goes from structures to mechanisms to events, as we can see in the figure above. In this thesis, the event in question is a global debt crisis, and the structure is the global monetary system. Therefore, the aim is to uncover the figure's middle part(s) and determine the possible systemic mechanisms with causal powers to create a crisis. Our next step is to clarify the properties of the underlying structure, which means examining the meaning of both the system and the crisis, respectively.

3. DECODING ‘GLOBAL DEBT CRISIS’

3.1. SOME REMARKS ON THE NATURE OF DEBT

Before we turn into global issues, we should address some general questions about the nature and meaning of debt. Debt is undeniably an elusive concept that often causes a strong emotional reaction. Even in academic literature, one sometimes finds moralistic arguments where debt is merely an enabler of bad economic behaviour and financial mismanagement (e.g. Rabie 2017, 163). These arguments stick because all of us have an idea of what being in debt means for our personal lives and the hardships it can cause. Owing someone something is a moral bind as much as it is an economic one, as the late anthropologist David Graeber has noted:

"Debt is a very specific thing, and it arises from very specific situations. It first requires a relationship between two people who do not consider each other fundamentally different sorts of being, who are at least potential equals (...) who are not currently in a state of equality – but for whom there is some way to set matters straight." (Graeber, 2014, 120)

Even though Graeber considers debts between individuals, the same principle holds with debts between institutions, countries, or any entities with the power to enter debt relations. His definition entails that for a genuine debt to exist, both sides must believe in the debtor's ability to pay. Unfortunately, this is not always the case in the international economy, as the controversies about so-called ‘odious debts’¹⁸ demonstrate. For debt to be enforceable, it should require legitimacy in the eyes of both the creditor and the debtor. Philosopher Alexander Douglas has pointed out that the use of compound interest in the capitalist economy has created a new class of debt that has the potential to grow so fast that it becomes genuinely unpayable at some point (Douglas 2016, 15). This principle applies both to people burdened with usurious credit card debts and sovereign countries that owe growing sums in foreign currencies they cannot sufficiently acquire. Therefore, despite our insistence of calling everything someone owes to someone as debt, there is a valid argument that these kinds of fundamentally unequal

¹⁸ Odious debts are ones taken by governments that the international community does not consider legitimate, leading many people to argue that those debts should also not be considered legitimate in the eyes of international law. Odious debts have caused controversy in many EMDE countries that have found themselves deeply in debt and at the mercy of their international creditors after overthrowing an authoritarian government. Of the discussion and possible solutions for odious debts, see (Howse 2007).

arrangements should not be considered a debt at all (Stiglitz and Heymann 2014, 6). There have been many calls for outright debt cancellations in the international debt arena or the need for creditors to at least accept some responsibility with excessive debt burdens, such as the Jubilee 2000-campaign. In sum, enforceable debts should require a legal basis and reasonable expectations of repayment.

In this thesis, we are interested in debt as a specific monetary phenomenon rather than a moral one. It is important to note that debt might be indispensable in a monetary sense. Many heterodox economists have long argued that there is no such thing as debt-free money or a debt-free economy.¹⁹ Instead, the hopes of eliminating the world's debt are based on a fundamental misunderstanding of how our monetary system works (see Wray 2015, 7). We will look into these claims further in Chapter 4 when examining the sectoral balances framework of the Modern Monetary Theory (MMT), where every asset equals a corresponding debt. However, we need to keep in mind that this definition of debt differs from the term's common usage where debt requires an explicit repayment. Therefore, the MMT's version of debt consists of much larger numbers than the 300 trillion IIF has estimated. When talking about global debt, this thesis usually refers to the debt as money, but the distinction will most likely be apparent in the context.

We will notice that the necessity of monetary debt creates a peculiar combination where individually we are concerned about debt, but our economic system cannot function without it. Our ambivalent attitude towards debt is likely a result of these conflicting goals. For example, Alexander Douglas argues that debt functions as a motor in the capitalist economy that has allowed production to expand and investments to grow to an unprecedented scale (Douglas 2016, 104). On the other hand, the capitalist accumulation process favours the creditors and, thus, carries a significant risk for debts to become extractive rather than productive if the debt service starts to crowd out investments²⁰ (ibid., 106-107). The challenge is to find a balance between competing interests and ensure that debt remains a productive force for the economy.

Naturally, these brief remarks cannot offer a comprehensive account of the nature of the debt. They merely emphasize the controversial nature of the concept and the economic phenomenon we still do not know how to approach appropriately. Therefore, we must strip the concept of

¹⁹ David Graeber, among others, has claimed that the idea of a debt-free economy is rooted in the writings of classical economists such as Adam Smith (Graeber 2014, 354). Smith presented the economy as a pure exchange between individuals, and neoclassical economists have since repeated his idea in various mathematical models.

²⁰ This process is called debt deflation which we will examine further in chapter 6.2.

debt from its multiple social and moral connotations for now and focus strictly on its role as an accounting tool for monetary claims between different actors, primarily sovereign nations. Global debt's political aspects will come back in the discussion section, but the central analysis will consider debt from the systemic perspective instead of individual actors. After this clarification, we can move on to another ambiguous but ultimately less controversial concept, a social scientific phenomenon of the crisis.

3.2. CRISIS IN A SOCIAL SCIENTIFIC CONTEXT

In everyday language, we use a crisis to define almost every significant adverse change in the life of a person or organization. A person can encounter a crisis in terms of health, relationship, or money; on the other hand, an organization can have a crisis in leadership, performance, or reputation, among others. The crisis has become a primary 'metaphor' for any hardships or challenges in life regardless of their actual severity. The well-known literary metaphors such as 'Crisis as a turning point' or 'Crisis as an opportunity' only add to the conceptual confusion. Crisis has simply become a synonym for something negative or even something negative that can turn into something positive. This situation does not mean that metaphors are a problem in themselves since our language is metaphorically constructed (Lakoff & Johnson 1980). Still, the ambiguity makes it more difficult to state meaningful arguments about a crisis.

Moreover, crisis talk is ubiquitous in social scientific literature, but it often refers to any possible social conflict of societal change. (Cordero 2014, 4) Studies dealing with the global political economy are no different in this regard. Even in the books that directly address debt crises, the crisis is usually vaguely defined. Stiglitz and Heymann give one attempt in *Life After Debt* where they state that "A crisis is a sudden change in the (perceived) state of the economy, one which is often associated with the collapse of a currency, the banking system, or the real economy." (Stiglitz & Heymann 2014, 46). This definition remains too broad since it simply equals crisis with a sudden change which can refer to almost anything happening in the economy. Majority of other relevant books and reports (e.g. Rabie 2017; Kose et al. 2020), merely assume the crisis as the given state of the economy without further clarification.

Carmen Reinhart and Kenneth Rogoff have made perhaps the best account of different types of financial crises in their book: *This Time is Different: Eight Centuries of Financial Folly* (Reinhart and Rogoff 2011b). They classify crises between those resulting from various

quantitative thresholds such as inflation and currency crashes and those resulting from banking or external debt crises. For example, while defining inflation crises, the authors have chosen a level of inflation they consider unacceptable (20% per annum) and classify every country over that threshold as being in crisis without further notice (ibid., 4-5). On the other hand, they conflate external and domestic debt crises with instances of sovereign default (ibid., 10-13). It seems that because Reinhart and Rogoff sought to define crisis through its effects instead of its inner mechanisms, they have ended up using several case-by-case definitions that vary considerably with every crisis instead of a universal definition for a crisis. In the context of a global crisis, this approach seems to be too arbitrary to be helpful for our case.

For the purposes of this thesis, we will utilize a strict but more universal definition of crisis. When examining global systems such as monetary and debt relations, the most applicable version found in the social scientific literature is a systems-theoretic approach to crises. Jürgen Habermas has, in his well-known book *Legitimation Crisis*, defined crisis as a situation where “the structure of a social system allows fewer possibilities for problem-solving than are necessary to the continued existence of the system.” (Habermas 1975, 2). In other words, the systemic crisis is some external or internal phenomenon with which the system cannot resolve within its own limits. When encountering a real crisis, the system cannot simply absorb its effects, but it needs to adapt to them. This interpretation emphasizes an acute severeness since a crisis is something that threatens the entire existence (or at least cripple the functioning) of a social system instead of being just a minor disturbance. According to Habermas, the result of an unchecked crisis is a disintegration of social institutions (ibid., 3).²¹

Habermas’s view acknowledges that social sciences cannot explain the world without concepts such as crisis and critique, even though some leading sociologists have claimed crisis to become an obsolete concept. (Cordero 2014, 2) Multiple types of social structures can and do encounter crises. In *Legitimation Crisis*, Habermas used his conception of crisis primarily to analyze the problems of capitalism in 1970s Western Europe. Still, there is no reason to believe that his version does not apply to debt-related issues too. The global monetary system and international monetary relations of states have their respective internal structures and dynamics that can be prone to crises for multiple reasons. Debt-induced crises are just one possible example.

²¹ Seyla Benhabib has advocated a similar view in talking about a “systemic crisis” regarding malfunctioning or severe disturbance of systems that deal with the distribution of resources (Benhabib 1986, 13).

One benefit of using Habermas's concept of crisis is that it does not render the crisis a mere 'speech act' or 'institutional fact' where something becomes a crisis just because it is declared as such (Searle 1995). The system-theoretic crisis has certain objectivity, and one can form testable hypotheses about its existence. It also prevents the claims of a so-called 'perpetual' or 'unending' crisis within an organization or country since its formulation is limited in time. Crisis either forces the system to collapse or (preferably) change and remove the factors that threaten its existence. If the system can go on unchanged, there was no real crisis, regardless of how much people have discussed it or how many times politicians declared it to exist. Nevertheless, the systems-theoretic concept of crisis is broad enough to cover virtually all major crises of our lifetime, such as the ongoing COVID-19 crisis or the ever-worsening climate crisis.²² It serves as a reminder that only the direst of situations that require immediate action are worthy of being called crises. With that in mind, the next section will clarify the properties of a system that can encounter a debt-induced global crisis.

3.3. FEATURES OF THE GLOBAL MONETARY SYSTEM

Let us take the systemic view of crisis as our starting point, where a crisis needs to force substantial changes to the current system by threatening its entire existence. Next, we need to clarify the features of our current system that can encounter such phenomena. Since we have established earlier that the version of debt we are concerned with is a monetary phenomenon, examining the global monetary system seems evident. However, the academic community has had a long-lasting debate about the essential features of our global monetary system or whether we can even classify it as a functioning system. In the following chapter, we will examine these questions.

3.3.1. OLD BRETTON WOODS SYSTEM AND ITS COLLAPSE

After the Second World War up until the early 1970s, a system existed to govern global monetary relations, namely the Bretton Woods system. Even though it was hardly coherent and

²² In a medical context, the definition of the Habermasian crisis is fulfilled if the disease threatens to overrun medical facilities or stop the normal functioning of the society, something that undeniably has happened during the years 2020-21. Similarly, the climate crisis has the potential to disrupt almost everything in our current system, but that topic is again outside the scope of this thesis.

suffered from many shortcomings, it was still a globally agreed system that provided the basis for cross-border monetary operations conducted by countries and the private sector. However, it did not include many of the crucial elements that one of its founders, John Maynard Keynes²³, had planned. Therefore, the system came under severe pressure in the late sixties and early seventies until it was ultimately dissolved by the United States.

The main feature of the Bretton Woods system for our purposes was the global reserve system based on the so-called dollar-gold standard. It meant that currencies throughout the world were not pegged to gold individually, but they were pegged to the U.S. dollar, which, in turn, was pegged to gold on a fixed rate of 35\$ per ounce. This arrangement was called ‘convertibility’, where the trust in the global reserve system depended on the ability of the U.S. to convert its dollar supply to gold if needed. Otherwise, the exchange rate system was fixed, so the monetary system's functioning rested on the dollar's dominance. (Eichengreen 2011, 66-68) The main aim of the dollar-gold standard was to guarantee the stability of international monetary relations and thus promote growth.

By establishing the dollar-gold standard, major countries wanted to avoid the earlier gold standard restrictions on countries' monetary operations. However, the dollar peg was still prone to creating tensions and exchange rate imbalances. The Bretton Woods system was able to function because the exchange rate pegs between the dollar and other currencies were ultimately adjustable under “fundamental disequilibrium”, and the international capital movements were heavily restricted. Furthermore, the newly created International Monetary Fund (IMF) was tasked to surveillance and support the countries that faced balance-of-payments problems due to the system's rigidity (Eichengreen, 2008, 91-92). Nevertheless, tensions that the dollar convertibility caused for the United States gradually created an insurmountable problem, as professor Robert Triffin noticed in the 1960s (Triffin 1961, 1968). This ‘Triffin Dilemma’ resulted from the system where a national currency was used simultaneously as an international reserve currency, which meant that the U.S. was forced to supply ever more dollars to ensure global liquidity and economic growth. Gradually, this development led to an increasing balance-of-payments deficit for the United States and eroded the confidence that it could sustain the convertibility of the U.S. dollar to gold. Because gold was (and is) a finite resource, the United States was not simultaneously able to provide the global demand for the dollar and maintain the dollar peg. Finally, President Nixon resolved the dilemma in 1971, when he

²³ On the suggestions of Keynes, see for example (Steil 2013).

unilaterally ended the convertibility and let the dollar float freely, effectively ending the basic premise of the Bretton Woods system.²⁴

We notice that the dollar crisis that Triffin formulated was quintessentially a systemic one. The international role of the dollar and the domestic monetary policy target (maintaining the dollar confidence) of the United States contradicted each other. Therefore, the convertibility system encountered a problem that it could not resolve within its own limits, and the result was the collapse of an entire system of monetary relations.²⁵ What replaced it was a complex set of floating currencies, and it is telling that academics are still debating what our global monetary system has become and where it is heading. The following sections examine a few possible answers to that question.

3.3.2. ARE WE STILL LIVING IN A DOLLAR-DOMINATED MONETARY SYSTEM?

Since the 1970s, our global currency system has been based on FIAT currencies, where governments alone determine the confidence for a currency. Even though the dissolution of the Bretton Woods system removed the main reason for the U.S. dollar's 'exorbitant privilege'²⁶, the dollar has managed to maintain its status as the world's top international currency (Eichengreen 2011, 2). However, there is an ongoing debate whether the dollar is still the *de facto* reserve currency of the world, even though it does not have an internationally agreed role as such.

Economic historian Barry Eichengreen has summarized this debate between what he calls Harvard and Berkeley views of the international monetary system (Eichengreen 2019). According to the former, our monetary system is, for all practical purposes, still based on the dominance of the dollar because empirically, the dollar forms the majority of both global foreign exchange reserves and foreign assets and liabilities of banks. This dominance seems not to have weakened much since the GFC, and there is some evidence that the hegemony of the

²⁴ This was planned first as a temporary measure, but the convertibility was never returned in effect. Many scholars have analyzed the reasons and effects of this "Nixon shock", one overview is given in (Barredo-Zuriarrain 2016, 40-44).

²⁵ It is entirely possible to argue that the original Triffin dilemma described a debt crisis since the growing United States balance-of-payments deficit meant increasing public debt levels, which the U.S. could not finance through the Federal Reserve (FED) operations because that would have ended the trust in the dollar convertibility. We will come back to the limitations that the U.S. faced then and now multiple times during this thesis.

²⁶ Even though this quotation has sometimes been attributed to French president Charles de Gaulle, it was his finance minister, Valéry Giscard d'Estaing, who first used it in the 1960s.

‘dollar world’ has only strengthened in time (Gourinchas 2021). No other currency comes close to having as broad appeal for international use as the dollar since their own problems prevent them from becoming serious challengers. Furthermore, the emerging economies also have an incentive to borrow in dollars since the dominant currency carries a lower overall economic risk (see Gopinath and Stein 2018). Therefore, the Harvard proponents argue that the monetary system with one dominant currency will safeguard the system and stabilize it over the long term.²⁷

Alternatively, the proponents of the Berkeley view remind us that even though the role of the U.S. dollar seems uncontested, it is probably just a historical anomaly. Multipolar international monetary arrangements have been the historical norm, and at some point in the near future, we are likely heading into a world of several competing international currencies (Eichengreen et al. 2019, 12). According to the Berkeley proponents, if these other currencies (such as Euro and Yuan) managed to establish themselves as safe and liquid assets the same way the U.S. dollar has done over the decades, that would create better stability in the world economy. Moreover, this view emphasizes that a unipolar monetary system is fundamentally unstable because it is vulnerable to the dominant currency issuer’s unwillingness or inability to uphold the currency system. (Eichengreen 2019, 235) Another concern is that the system based on the U.S. dollar will inevitably face a twenty-first-century version of the Triffin Dilemma.²⁸ In sum, the academic debate about the role of the dollar is fundamentally between those who look to the matter empirically (where the status of the U.S. dollar seems to be globally unrivalled) and those who look at it more historically (where political and historical developments constantly threaten the position of the U.S. dollar).

Especially after the GFC, there have been multiple calls for reforming our international monetary system for a less dollar-centred one (Xiaochuan 2009; Farhi et al. 2011; Valdecantos and Zezza 2015). Most proposals start from the premise that the dollar's dominance makes our global monetary system more unstable. Usually, they suggest diversifying the currency reserve pool by either increasing the use of the Special Drawing Rights²⁹ (SDRs) issued by IMF or even

²⁷ This view comes close to Charles Kindleberger’s idea of hegemonic stability, which he also claimed to function as a safeguard against financial crises (Kindleberger 1981).

²⁸ We will examine these concerns and their plausibility further in chapter 6.1.

²⁹ Special Drawing Rights are an international reserve asset, created in the late 1960s and issued by the IMF, which countries can use for liquidity during the financial crisis. They are the closest thing we have to global currency, but they cannot be used for private transactions and, therefore, they are not classified as an acceptable currency. Instead, every IMF member state has its own allocation of SDRs, which it can exchange with foreign currencies, thus providing liquidity. The use of SDRs has increased markedly during the COVID-19 crisis. For the IMF's internal view for the future of SDRs in the global economy, see (IMF 2018).

creating a universal reserve currency in the spirit of Keynes' 'Bancor'³⁰ proposal. Some reform proposals also advocate reinstating capital controls on some level, at least in the EMDE countries (Farhi et al. 2011, 44-46). Of course, the reasons for suggesting the reforms are often not purely economic since the complex global questions of hegemony and multipolarity also play their role. Nevertheless, no serious reform proposal has yet been implemented on the international level, and the attempts to challenge the dollar have so far been scant.

3.3.3. JOSE ANTONIO OCAMPO AND GLOBAL MONETARY NON-SYSTEM

What if one cannot describe our monetary system in any mutually agreed way because there is no existing system with agreed rules and conventions? Economist Jose Antonio Ocampo has suggested that our global monetary relations do not constitute a coherent system but are merely a set of fragmented ad hoc arrangements resulting from the market pressure and failure to reform the remnants of the old Bretton Woods system (Ocampo 2017, 29). Ocampo calls our current situation a veritable 'non-system' because of the competing exchange regimes and the lack of global coordination in monetary issues. Indeed, his insights reveal many flaws and vulnerabilities of our global monetary relations.

Ocampo agrees with the Harvard view that the dollar effectively functions as a global reserve currency which the SDRs complement to some degree. However, for him, that is not enough to constitute a system worth the name since most other currencies are not bound to the U.S. dollar. Countries are free to choose their own exchange rate regimes as long as they do not manipulate them unnecessarily (ibid., 29). In addition, the amount of SDRs issued is nowhere close to challenging the dollar or any other international currency. Ocampo is among those who have long argued for more extensive use of SDRs to smooth the imbalances in the global monetary flows or, preferably, make SDRs a basis for a new global reserve system (Ocampo 2010).

Ocampo admits that the ad hoc arrangements have proved to be surprisingly resilient, but he believes that their gaps have had significant adverse effects on the world economy. Ocampo has listed the major gaps in our current system being:

- The deficiencies of the global reserve system.
- The weakness of global macroeconomic cooperation.

³⁰ See the discussion chapter.

- The lack of an exchange rate system.
- The instability generated by procyclical capital flows, particularly for emerging economies.
- The absence of an adequate sovereign debt restructuring mechanism. (Ocampo 2017, 43)

Especially the lack of a global lender of last resort has led to a situation where developing countries have an incentive to accumulate large foreign exchange reserves as a self-insurance policy, which distorts the global monetary relations.

These deficiencies have resulted in a world where countries are more or less free to make monetary decisions as they please, for there is no well-defined set of rights and obligations in place. However, because of the global power imbalances, this does not mean that every country has the same level of freedom to make decisions. Ocampo has elsewhere argued that the largest economies have effectively taken the wheel in global monetary issues since, currently, the most consequential arena for negotiations are various G-groups (G7, G8, and G20). He has repeatedly called this decision-making process ‘elite multilateralism’ (Ocampo 2011, 10). For Ocampo, the problem with this arrangement is that it cannot and should not replace representative institutions, which a well-functioning global monetary system should include. Specific regional arrangements for financial cooperation, such as Multilateral Development Banks (MDBs), have too limited a scope to influence global cooperation markedly. Inadequate representation from the developing countries in the most significant arenas is something Ocampo has often criticized over his career. Therefore, according to Ocampo, the closest thing we have of a global monetary system is essentially a state-centric web of monetary relations, where the dollar plays a disproportionately prominent role.

In the light of these competing viewpoints, what can we determine as the essential features of our global monetary system that can be susceptible to a debt crisis? In other words, what would need to change and adapt because of the reasons resulting from debt-related issues? In the early 1970s, the Bretton Woods institutions were forced to adapt, leading to significant changes in the IMF and World Bank priorities, among other things (Soederberg 2005). Currently, it seems, either the U.S. dollar or the monetary relations between countries would need to break down for a systemic crisis to develop. A more multipolar currency regime remains a future possibility, but the U.S. dollar is at the heart of international monetary stability, owing to its de facto reserve role. Furthermore, the absence of functioning global monetary architecture has paved the way

for systemic imbalances, which, according to Ocampo, means that: “...world economy is hostage to the monetary policy of the main reserve-issuing country” (Ocampo 2017, 211).

We will examine in later chapters whether this statement holds and its implications for a possible global debt crisis. For now, we can only offer a hypothesis that a systemic crisis would be an event that forces significant and abrupt changes in the monetary relations between countries, especially between the major currencies. Even Ocampo’s non-system presupposes the existence of a system of independent counties and economic regions. Therefore our next chapter will consider the economic theory more closely and offer an alternative perspective for the role of debt in the system and perhaps even for the monetary system itself.

4. MODERN MONETARY THEORY AND ITS VIEWS ON DEBT

Many academics who do not endorse the mainstream neoclassical views of money and debt have found a theoretical background in post-Keynesian economics, especially in one of its more popular variants Modern Monetary Theory (MMT).³¹ At the heart of the MMT is the perception that **money matters**; it is not just a veil of production, and we cannot represent the world with models that rely on the barter-economy of goods and services without the relations of money and debt. MMT economists agree with the post-Keynesian idea of endogenous money, where the money supply is determined endogenously by the willingness of banks to lend, and that reserve requirements do not limit the credit creation of banks (Fullwiler 2013). Bank lending creates deposits, not the other way around. Furthermore, MMT economists abandon the neoclassical idea that central banks alone control the money supply, and these reserves constrain bank lending. In the MMT view state does not determine the quantity of money in circulation (exogenous view), but the growth of money supply responds to the demand for money in the overall economy (endogenous view) (Wray 1998, 34). In principle, nothing constrains the issuing of money apart from its inflationary effects and the willingness of the people to use it.

³¹ Some Post-Keynesians have been cautious of particular MMT policy suggestions, but generally, its contributions are acknowledged as a part of the Post-Keynesian tradition (Juniper, Sharpe, and Watts 2014). On the various other strands of Post-Keynesianism and their mutual relations, see (Lavoie 2014).

Most heterodox economists agree that both private (banks) and public (government) entities can issue money. However, the MMT economists emphasize the state's role in money creation and put government money at the top of the so-called 'money hierarchy' (Bell 2001). This neo-Chartalist³² view claims that modern money derives its value from its use to pay certain liabilities to states, primarily taxes. L. Randall Wray, among others, has argued in length that the state's power to require taxes to be paid in certain currencies is the primary reason upholding the demand of these currencies (Wray 1998, 18-37). Even though most money is created endogenously by private banks when they issue a credit, its value is ultimately guaranteed by governments accepting it as a means of payment.³³ This requirement gives governments significant power over monetary decisions since they are also the entities issuing currency.

Suppose we accept the MMT principles of endogenous money and taxes driving the demand for currency as correct. In that case, it allows currency-issuing states much more freedom in fiscal policy than the mainstream theories recommend since there will always be a demand for state-issued money. For MMT economists, the ultimate constraint for government spending is not the amount of money in its Treasury but the available productive resources in the economy (Kelton 2020, 11). For that reason, most MMT economists recommend that states abandon the idea of a balanced budget and opt for deficit spending whenever their fiscal goals require it, a principle known as Functional Finance (Lerner 1943). Of course, this does not mean that governments just can (or should) print out more money to fix every economic problem since, at some point, inflationary effects would grow too great. However, as long as the economy has not utilized all of its resources (by achieving full employment, for example), these effects would not necessarily be harmful to the overall economy. MMT economists simply suggest that governments should not be afraid of going heavily into debt if they can utilize the deficit spending in a socially desirable way.

The description above has briefly presented some underlying principles MMT has about the nature of money and its relationship with the state. To broaden its scope, many MMT economists have worked hard in recent years to build a coherent macroeconomic framework around MMT principles (Mitchell et al. 2019). For our argument, we do not need to assess the pros and cons of MMT and its relation to other economic theories since that debate is ongoing

³² Chartalism refers to money's role as an accounting token instead of its intrinsic metallic value. Chartalism is usually used parallel to a so-called State Theory of Money formulated by C.F. Knapp in the 1920s, see (Bell 2001).

³³ This view is parallel to Hyman Minsky's famous quote about the nature of money: "everyone can create money; the problem is to get it accepted" (Minsky 2008, 255), which emphasizes the social nature of money.

elsewhere (see Tymoigne and Wray 2015; Fullbrook and Morgan 2019). Furthermore, MMT as an economic framework is being applied to a growing number of economic fields, meaning this thesis cannot provide a comprehensive account of all (or even most) of them.³⁴ Instead, we need to examine how the MMT framework leads to a set of counterintuitive consequences for both national and global debt, in addition to its monetary views. Let us take a closer look into a couple of the most significant parts of this framework and their meaning for global debt issues.

4.1. SECTORAL BALANCES FRAMEWORK

The MMT view of examining the economy follows the idea of sectoral balances or a so-called ‘stock-flow consistent’ (SFC) model, theorized extensively by Wynne Godley (Godley 1996; Godley and Lavoie 2007), that comprehensively considers all stocks and flows within the national economy. This integrated approach examines the national economy as a totality where no flow of funds between sectors ever disappears or goes to waste. Instead, every monetary transaction keeps circulating within the economy. This circulation is accompanied by the fundamental accounting principle that one person’s or sector’s financial asset is always a financial liability for others.³⁵ Godley has argued that the SFC model is the most compatible with the principle of endogenous money and, therefore, best suited for our economic reality (Godley 1999).

In the framework of sectoral balances, the national accounts are divided into the private domestic sector (households and companies), the government sector (state and local levels of government), and the external sector (monetary flows to and from outside the borders of a country). MMT takes it as an accounting necessity that nationally these three sectors will always balance each other out since monetary flows can only transfer between them or within them. L. Randall Wray has demonstrated the relationship between the government and the private sectors: “If the government always runs a balanced budget, with its spending always equal to its tax revenue, the private sector’s net financial wealth will be zero. If the government runs continuous budget surpluses (spending is less than tax receipts), the private sector’s net

³⁴ One central policy area outside this thesis where the framework of MMT has been used is labour economics. MMT economists have long argued alongside other Post-Keynesians that, following from the principles of Functional Finance, full employment should be a key policy goal for every nation, and the state should take responsibility as an ‘employer of last resort’ (see Mitchell and Muysken 2008).

³⁵ My summary of the SFC model is only meant to give away the general idea. A much more comprehensive and detailed account is given in (Godley and Lavoie 2007).

financial wealth must be negative. In other words, the private sector will be indebted to the public sector” (Wray 2015, 11).³⁶ We can complement this duality by adding the external sector, allowing both private and public sectors to run surpluses simultaneously. However, in that case, the rest of the world needs to be in debt to that country’s public and private sectors.³⁷ The framework of sectoral balances reminds us again of the fallacy of composition: what is possible for one economic sector might not be possible for all sectors simultaneously, and therefore futile to pursue. The following picture demonstrates this unavoidable economic fact.

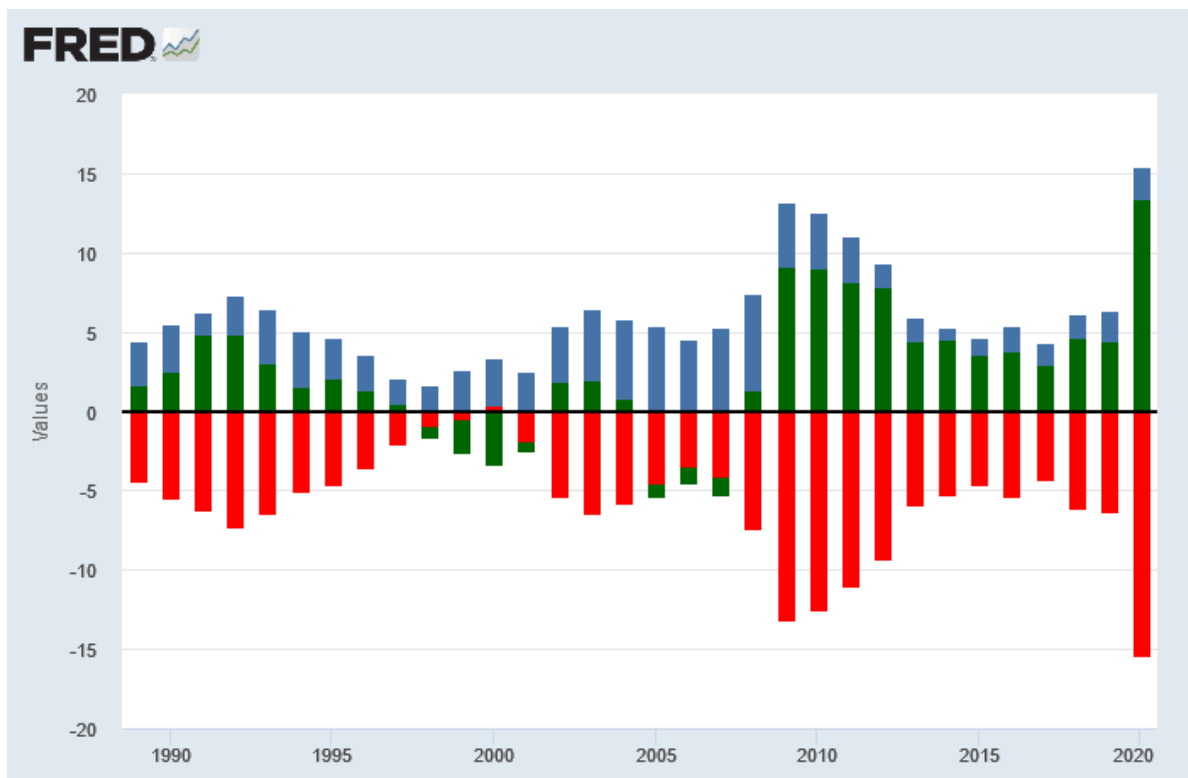


Figure 3. Federal reserve economic data of the U.S. yearly sectoral balances (as % of GDP) 1990-2020. The graph differentiates the sectoral lending/borrowing between the government sector (red), the private domestic sector (green), and the external sector (blue) (Federal Reserve Bank of St Louis 2021).

³⁶ It is crucial to note that these arguments apply only at the aggregate level. Even if the private sector’s net wealth is zero, multiple private actors can have a massive amount of financial assets. However, on a sectoral level, they are negated by equally massive financial liabilities of different private sector actors.

³⁷ Since my purpose is only to highlight the importance of this framework for our perception of debt, I have omitted many details, such as the role of the exchange rates, since they do not alter the fundamental argument. For a more extensive account, see (Wray 2015, 55-62).

By applying the sectoral balances framework, we can see that debts are an indispensable feature of the monetary economy since no financial asset could exist without a corresponding debt somewhere and vice versa. The U.S. sectoral balances chart shows us that, for the last 20 years, it has been the government sector taking in the debt load. Similarly, the chart shows that the principal benefactor from these sizable federal deficits has been the domestic private sector, at least since the GFC. Another way of interpreting the framework of sectoral balances is that no sector can amount surpluses or deficits purely by its own will since other sectors must always accommodate them. Eric Tymoigne has illuminated the relationship between the U.S. government sector and the external sector as follows:

“If the rest of the world ever thinks the net financial accumulation of USD is too large, the only way foreigners can reduce it is by buying more goods and services from U.S. sectors (U.S. exports rise), cutting sales of goods or services to U.S. sectors (U.S. imports fall), reducing their reliance on USD - denominated incomes and transfers, selling USD to U.S. sectors, and/or repaying debt owed to U.S. sectors.” (Tymoigne 2020, 61-62).

Even though most MMT economists have limited to use of SFC models in national economies³⁸, there is no reason to assume why the principle of sectoral balances would not apply globally. Actually, measuring sectoral balances would be even more straightforward since the world is a closed economic system with no external sector.³⁹ Therefore, it is difficult to exaggerate the implications of the sectoral balances framework for our perception of global debt. On a global level, this fundamental principle means that the world economy cannot function without large debts since they form a basis for monetary assets in other sectors. In conclusion, the amount of debt cannot be a problem in itself since obliterating all debt would mean losing the entire monetary basis of economic transactions. Therefore, the framework of sectoral balances helps us to move away from focusing blindly on the sheer number of global debt and towards the more relevant questions of who are indebted, to whom, and who has the power of enforcing the debt obligations. The following framework offers some light on the latter question.

³⁸ Even in (Godley and Lavoie 2007), which many see as the most comprehensive book on this subject, the focus is strictly on national models.

³⁹ Of course, the classification between economic sectors should probably be adjusted somewhat way for sectoral balances to remain relevant globally, but the fundamental principle of their use would still hold.

4.2. MONETARY SOVEREIGNTY FRAMEWORK

Regarding the arguments around debt and deficit, perhaps the most crucial principle for the MMT is the notion of monetary sovereignty and its implications for monetary operations. Therefore, MMT economists set a relatively high threshold for a country to attain it. For to be considered monetary sovereign, a country needs to set its own domestic currency and both issue its public debt and demand the payment of government dues in that unit of account (Tymoigne 2020, 50). In addition, a country must neither peg the value of its currency to any other internationally used currency nor to any precious metal, such as gold. If the requirements are fulfilled, a country may never involuntarily default its domestic debts since it can always issue more currency to cover the debt service (or print money, in more conventional terms) (ibid., 62-63). MMT economists have long stressed that this fact should alleviate many fears surrounding the rising debt levels in countries such as the U.S.

L. Randall Wray has argued that for the monetary sovereign nation, many widespread beliefs about government spending, such as the following, are simply false:

- Governments have to raise funds through taxing or borrowing.⁴⁰
- Government deficits drive interest rates up, crowd out the private sector, and lead to inflation.
- Government deficits take away savings that could be used for investment.
- Higher government deficits today imply higher taxes tomorrow, to pay interest and principle on the debt that results from deficits. (adapted and shortened from Wray 2015, 103-104)

Following the sectoral balances framework, government deficits mirror the private and foreign sector surpluses, so claiming they necessarily crowd out the private sector or hinder its investment is false. Also, tax hikes are a political choice for monetary sovereign countries rather than an economic necessity for covering expenses. On the other hand, inflationary effects of deficits may theoretically become an issue, but only after the economy is running with a near-

⁴⁰ Most MMT economists agree that because monetary sovereign governments are not dependent on tax revenue to finance their spending, it is not correct to say the taxes or issuing bonds finance government spending at all (Bell 2000). Accordingly, government bonds should be considered more as interest-bearing savings held at the central bank instead of calling it a debt as such. However, this view in no way makes taxes redundant (remember the MMT argument that taxes form a basis for government currencies); it just fundamentally alters their purpose. The arguments of this thesis do not depend on the taxation debate, but for a more extensive analysis of the role and functions of taxes, see (Murphy 2015).

maximum capacity. By clearing these misunderstandings around government deficits, MMT shifts the focus from government budget constraints into more crucial resource and political constraints. Since involuntary debt default is an impossibility for a monetary sovereign nation, the only way for such a nation to encounter debt service problems is to declare self-appointed political constraints.⁴¹

Unfortunately (from the MMT perspective), the degree of monetary sovereignty varies considerably between nations. MMT economists make a profound distinction between currency-issuing and currency-using nations where the latter cannot enjoy monetary sovereignty (Kelton 2011). Countries that have pegged their currency to some other currency (usually to the U.S. dollar) or outright abandoned their issuance of currency (such as the Eurozone member states) are not considered monetary sovereign. Accordingly, the Eurozone as a whole is a monetary sovereign economic area, but its member states are still susceptible to external debt crises since they cannot issue euros themselves. For this reason, some MMT economists have repeatedly proposed reformulating the rules of EMU and transferring more budget power to the Union level (Wray 2015, 180-191).

Furthermore, countries with high amounts of foreign debt will still be subject to varying degrees of financial constraints since they need to either earn or borrow the foreign currency they are indebted in. As we can see in the multiple cases of Third World debt crises, significant accumulations of dollar-denominated debt can indeed prove to be catastrophic, regardless of the usage of the domestically issued currency. Therefore, one should view monetary sovereignty as a spectrum rather than a clear-cut capacity a country can have. As a result, some researchers have criticized MMT for ignoring this grey area since, especially in the case of the developing world, the degree of monetary sovereignty is often ambiguous (Bonizzi et al. 2019; Kregel 2020; Prates 2020).

Given the U.S.-centered nature of MMT research, most policy recommendations for monetary sovereign nations have focused primarily on the United States (e.g. Fullwiler 2006; Kelton 2020). Still, they are similarly applicable to the UK, Australia, Canada, Japan, and ultimately any country that fulfils the earlier sovereignty requirements. Contrary to what Eichengreen and others argued in Chapter 3.3.2., monetary sovereignty means that despite the prominent role of the dollar as a de facto global reserve currency, the United States should not be the only country with the ‘exorbitant privilege’. Every monetary sovereign nation has the same privilege of broad

⁴¹ In the discussion chapter, we will come back to this when examining the debate around the U.S. debt ceiling.

fiscal space if they have the political will to use it. In particular, MMT economists have used Japan as an example of a country with a massive public debt burden but no difficulties in servicing it, even though there is an ongoing debate whether Japan has otherwise followed the policy recommendations of MMT (Wray and Nersisyan 2021).

An important implication of monetary sovereignty is removing one of the essential tools for market pressure, namely volatile interest rates. Countries that issue debt in currencies they do not control will always have to worry about the confidence of the market forces and the possible threat of rapid interest rate hikes. On the other hand, monetary sovereign nations can almost exclusively set the overnight interest rate for the government bonds since there will always be a demand for them. As L. Randall Wray has argued about the U.S. bond issuance:

“...there are approximately 40 primary dealers that are required to bid competitively for Treasury securities, which keeps rates as low as possible. The dealers do this mainly because their clients will deal only with primary dealers. This means that Treasury can always sell securities and can always get deposits at the Fed in order to spend. The self-imposed ‘constraints’ are not a constraint. There are no ‘bond vigilantes’ who might prevent Uncle Sam from spending by refusing to lend to him.” (Wray 2015, 102).

In other words, the United States has an in-built system of ensuring demand for its sovereign debt, even if we dismiss the ability of the Federal Reserve to purchase Treasury securities directly. These types of mechanisms demonstrate again how impossible it is for a monetary sovereign nation to involuntary default on its domestic debts. Furthermore, they show why monetary sovereign nations should not fear that the cost of debt service would get out of hand, as it demonstrably has not in nations such as the U.S. (Fullwiler 2016, 34-36).

4.3. MMT:S RELATION TO GLOBAL DEBT – CONTRIBUTIONS AND LIMITATIONS

The previous frameworks show that MMT takes a considerably different approach to debt than the mainstream economic theories. This approach often seems reckless and even dangerous for many mainstream economists for not expressing a sufficient concern for rising debt levels.⁴²

⁴² Ironically, some heterodox economists have reversed the argument and accused the neoclassical economists of ignoring the role of debt in the global economy or taking its effects too lightly (Pettifor and Bush 2003; Hudson 2009, 2015). We will come back to this argument when examining the role of debt deflation.

However, the whole point of MMT is to switch the focus on the more relevant aspects of our debt infrastructure. The abovementioned principles are explicitly meant to counter widespread myths about government deficits and debt. One of the main political goals of MMT economists is to offer an alternative view for fiscal sustainability and dampen fears of issuing sovereign debt (Fullwiler 2016). Some might argue they have been moderately successful. In recent years, the argument that the dangers of public debt have been overestimated has gained ground among mainstream economists as well (see Blanchard 2019; Eichengreen et al. 2021). It remains to be seen whether the worldwide fiscal stimulus during the Covid-19 pandemic will lead to greater political recognition of MMT principles or whether the theory remains in the academic circles for now.

The primary question for this thesis is what are the global implications for using the MMT approach in debt issues. The question is complicated and requires much more scholarly attention than it has yet received. However, we can summarize a few points that follow from sectoral balances and monetary sovereignty frameworks. First, since (both nationally and globally) every surplus must match with an equal deficit, some economic actors must always be massively in debt for our global monetary system to function. The global circulation of money is backed mainly by the existence of debt, and the main reason for money to disappear from circulation is when these debts are paid.⁴³ Second, it is financially much safer for monetary sovereign entities to be in debt, for they have no danger of involuntary insolvency.⁴⁴ Since there are no widely used private currencies in our FIAT-money system, the result is that from the systemic perspective, **high levels of private debt are generally more dangerous than high levels of public debt**. The entire private sector is subject to the pressure of the global financial markets, while, in reality, only part of the public sector is. Therefore, the persistent government sector deficits are often sustainable at the overall economic level, whereas the persistent private sector deficits rarely are (Wray 2015, 66).⁴⁵ This difference will also be highly relevant for global debt, affecting the two mechanisms we examine later.

However, the policy recommendations of MMT are centred around government deficits, so it is debatable how well they work on a global level. As some Marxist critics of MMT have noted:

⁴³ One can also argue that, for all practical purposes, money stored in tax havens or invested in other non-productive assets is also removed from circulation. However, this thesis cannot explore this theme further.

⁴⁴ In general, mainstream economics also recognize that public debt is a safer investment for private investors since its default risk is much lower, see (Azzimonti and Yared 2019). However, these accounts do not examine the effects of monetary sovereignty.

⁴⁵ We need to stress again that they are sustainable in the sense of not encountering a systemic crisis, not in the sense of being always desirable.

“The passage from the national to the international realm is a major problem for neo-Chartalist theory as there is no supranational state choosing units of account or having the power to tax at the international level.”(Aguila and Lapavitsas 2021). More importantly, we do not have a single global currency or a legally defined global lender of last resort that might apply the MMT principles. Therefore, many political insights between the relation of state, money, and debt that MMT economists have made over the years have limited value on the global level. MMT as a theoretical framework is designed to guide policymaking of monetary sovereign nations, not global processes and monetary mechanisms. Therefore, we need to be careful how to use the frameworks of sectoral balances and monetary sovereignty with global debt issues and remember to separate their descriptive views from policy recommendations when assessing the mechanisms for a global debt crisis.

5. DIFFERENCES BETWEEN SOVEREIGN AND GLOBAL DEBT CRISES

5.1. MECHANISMS FOR SOVEREIGN DEBT CRISES

Before we move into examining the possible features of a global debt crisis, we should take a brief look at the mechanisms that have caused sovereign debt crises throughout history. They give us an insight into how their mechanisms differ from the crises happening on a global level. We should also remind ourselves of Habermas’s definition of crisis, where the system's existence is in danger, and the system cannot resolve these dangers by its own means. In the context of sovereign debt, this would mean either a country forced an externally led debt restructuring or outright debt default. How have these debt crises originated?

The most crucial factor of sovereign debt crises is that they mainly occur in non-monetary sovereign countries. Given the dollar’s primacy in international markets and the weak financial institutions in many developing countries, most of the world’s currencies cannot guarantee monetary sovereignty. Instead, countries need to amass external debt (either in dollars or some stronger regional currency) to fully participate in the world economy, especially after the liberalization of international capital markets from the late 1970s onward. Reinhart and Rogoff have gathered a comprehensive picture of all external debt defaults and reschedulings from the

last two centuries (Reinhart and Rogoff 2011b, 89-100), where one can see a sharp hike in external debt crises after the 1970s. The crises centred on Latin American and African countries with a disadvantageous position in the world economy.

Mechanisms behind the so-called Latin American Debt Crisis of the 1980s highlight the importance of external factors behind the debt problems. The crisis started when the U.S. raised its interest rates steeply in 1979 to combat rising inflation (an event known as a Volcker Shock), which meant a sharp rise in the debt service burden for all countries with debt denominated in dollars. In Latin America, the combined effects of external debt, floating interest rates, and the simultaneous sharp drop in real commodity prices meant that most countries could no longer service their dollar-denominated debt (Ocampo 2014, 96-99). The result was a series of debt defaults and restructurings leading to a decade-long severe recession in the region. The dependence of many Latin American countries on international bank lending made their problems only worse since the confidence loss almost stopped the bank lending in the 1980s (Griffith-Jones and Sunkel 1986, 100-101). In effect, their international creditors forced most Latin American countries to go through heavy structural adjustment programs during the decade, which prioritized debt repayment over economic development.⁴⁶ Many scholars have argued that the multiple debt restructuring negotiations heavily favoured the interests of creditors instead of developing the region, which resulted in the 'lost decade of development' in the 1980s (Carrasco 1999). Dependence on the U.S. dollar was a necessary background factor in the crisis that escalated after events no country in the region could control.

The experiences of Latin America illuminate the dangers of conducting international trade with a currency outside one's own control and without any other international body to arbitrate debt issues besides international bond markets. In addition, the markets often place the responsibility of resolving the debt burden solely on the debtor countries and ignore the counterpart of excessive lending. The one-sided focusing on the external debt burdens also downplays the fact that other forms of financial crises often accompany sovereign debt crises. Reinhart and Rogoff, among others, have emphasized the links between external debt defaults and banking crises preceded by rapidly rising private indebtedness (Reinhart and Rogoff 2011a).⁴⁷ From the MMT

⁴⁶ During the decade, the structural adjustment was complemented with modest debt restructuring and relief plans (Baker plan and Brady Plan). For a more extensive account of the debt relief programs in Latin America, see Ocampo's and Sanguinetti's chapters in (Stiglitz and Heymann 2014). They also emphasize the link between the U.S. banking crisis and the Latin American debt.

⁴⁷ In addition to the external debt crises, Reinhart and Rogoff have also gathered a list of domestic debt crises over the last three centuries (Reinhart and Rogoff 2011b, 110-118). The MMT view is that involuntary default of domestic debt

perspective, one could argue that the difficulties of monetary non-sovereign countries to conduct effective monetary policy makes them more susceptible to all forms of financial crises. Suppose the state is structurally dependent on the provision of private credit. In that case, the possibilities of volatile interest rate changes are poison for high external debt, especially if the country has low international reserves (Kose et al. 2020, 15-16). All it takes is an external or internal financial shock to create a self-fulfilling crisis of plummeting market confidence and untenable debt service, as we have seen repeatedly in recent decades.⁴⁸

The prolonged debt crises bring us to another question: Why don't countries simply default all of their external debts if continuing the debt service would cause adverse effects in their economies? For centuries sovereign defaults were more or less the norm on the international stage (Reinhart and Rogoff 2011b, 87-93), whereas nowadays, even partial defaults create terror in financial markets. Jerome Roos has attempted to answer why the willingness to default has dropped in recent decades in his book *Why Not Default?: The Political Economy of Sovereign Debt* (Roos 2019). In regards to the political mechanisms that may enforce debtor compliance, Roos has identified three possible cases: (1) market discipline from international creditors, (2) conditional loans from international institutions, and (3) internal pressure from the political elite (ibid., 69-82). He argues that the structural power of finance⁴⁹ has grown so massive in recent decades that creditors can usually unite in their interests and act as a powerful force towards individual debtor governments.

Furthermore, the objective of international lenders has established itself as keeping the debtor country solvent by implementing conditional loans so that the debt service can continue indefinitely. For monetary non-sovereign countries in need of further external loans, this combination heavily favours the continuation of debt service. In addition, Roos acknowledges the role of the domestic political elite, who usually favours easy access to international credit markets and, therefore, often take the creditor's side in demanding austerity measures from the government. For Roos, all of these three mechanisms would need to break down for default to

is an impossibility, meaning that these defaults should be analyzed as political decisions made by the respective governments. Indeed, it is noteworthy that many of these domestic defaults are linked with the collapse of governments and severe political unrest.

⁴⁸ Although the link between banking crises and sovereign debt crises is highly relevant, it is not a central theme of this thesis where the focus is on global perspectives. *This Time is Different* offers an excellent starting point for further academic debate on the subject.

⁴⁹ The concept of the structural power of finance is borrowed from Susan Strange. For the overview of the concept, see (Guzzini 1993).

become feasible, which means that in our current system, monetary non-sovereign countries are easily forced into market compliance when regarding debt issues (ibid., 70).

Even if one disagrees with Roos's bleak picture of repressive financial power, there is no denying that prolonged sovereign debt crises are frightening possibilities for monetary non-sovereign governments. However, their existence depends both on countries taking on large amounts of external debts and the creditor-favouring features of the international monetary system. Moreover, only a highly unequal power structure between countries can force governments into a situation where foreign powers can dictate their debt management. A systemic debt crisis would not be possible if the international monetary system recognized the practical importance of monetary sovereignty and would help each country attain it.

5.2. WHY SOVEREIGN DEBT CRISES CANNOT CAUSE A GLOBAL CRISIS

We are now ready to draw preliminary conclusions on the differences between debt crises across societal levels. First of all, debt crises are most disastrous on the private level, where people and companies are usually powerless in the face of their creditors' will. Some scholars have argued that private debt crises are becoming systemic since the inherent structure of capitalism is dependent on indebted subjects (Lazzarato 2012). Susanne Soederberg has described a rise of so-called 'debtfare states' where the growing surplus population is forced to recourse to private credit to subsidize their basic needs (Soederberg 2014, 46-47).⁵⁰ According to these views, private debt is a coercive system that can only break down with the radical reformation of society. However, despite their harmful effects, these tendencies would not automatically result in a global debt crisis that would threaten the existence of the international monetary system. On the contrary, the existing system might even be dependent on the increasing levels of private indebtedness.

Furthermore, we see there is little reason to suppose that sovereign debt crises would automatically lead to a global systemic crisis either. Those who warn it would usually rely on the assumption that the global debt crisis is merely an accumulation of sovereign crises. For

⁵⁰ Soederberg's work is focusing especially on the credit card and student loan industries in the Anglo-American world. Her views might contribute to the study on debt deflation (see chapter 6.2.) but otherwise they are more applicable in the national context.

example, Jorge Carrera has argued for a possible contagion effect of multiple sovereign debt crises in *Life After Debt* as follows: “This is a crisis that started at the center of the system, which implies that mechanisms of shock transmission and contagion are at play on a worldwide scale. Any single crisis may potentially have more disruptive effects within a global context because of increased external interconnections and the weaker legal and economic protection of these links.” (Carrera 2014, 310). This line of argumentation forgets that sectoral balances of debt and credit cancel each other out globally; there is no possibility that every economic sector would suffer from crisis contagion. Moreover, the contagion of sovereign crisis would require an increasing amount of monetary non-sovereign countries with high external debts. This chain of events would stop somewhere long before it reaches a global level. In addition, the global monetary system does not suffer from the primary triggers of sovereign debt crises, such as high external debt levels. Therefore, considering sovereign and global debt crises as an identical phenomenon is an example of the fallacy of composition.

With everything we have examined in mind, we can now return to the Introduction’s claim, made by the World Bank report, that we are experiencing the fourth wave of debt, a first genuinely global one (Kose et al. 2020, 113-120). The numbers are solid; our world has never encountered such a large wave of debt. However, the assumption that waves of debt in different regions signal that we are in the middle of a global debt crisis is seriously flawed. There is a level of difference between the relevant features of debt from a sovereign and global perspective and, therefore, a level of difference between the triggering mechanisms as well. Sovereign debt crises cannot function as a cause for a global debt crisis because, on the global aggregate level, debt transforms from being an external economic burden to a guarantee of global monetary activity.

In conclusion, what has come of our hypothesis that there must be differences in the causal mechanisms between the sovereign and global debt crises? The point that deserves repeating is that the existence of a sovereign debt crisis almost always presupposes heavy external lending and an unequal power structure between the creditor and debtor countries, i.e., limited monetary sovereignty.⁵¹ Therefore, we notice that MMT principles support the first hypothesis of this thesis. Monetary sovereignty largely determines the power to issue debt in a situation where most of the problems with excessive debt are caused by a vast power imbalance between debtors and creditors. However, no one has the power to pressure the global system from the outside

⁵¹ Of course, political calculations may also contribute to the instances of default, see the discussion chapter.

since all debtor and creditor relationships are contained within the system. The same idea functions with sectoral balances where the system itself contains all monetary and debt relations. Thus, the principles of MMT lead to a conclusion that the global systemic debt problems must have different causes than those problems arising from the debt relations between debtor and creditor nations. Our next chapter attempts to evaluate whether the academic community has presented credible causes for the global systemic debt crisis and, if so, how the crisis could unfold.

6. GLOBAL DEBT CRISIS: TWO POSSIBLE MECHANISMS

This chapter attempts to answer the second research question of this thesis: Which mechanisms, if any, can cause a debt crisis at a global level? By now, we should have established that high public debt levels cannot trigger a global debt crisis by themselves. Similarly, it should be evident that being indebted in a foreign currency and the following enforcing power of creditors leading to the crisis does not apply to the global system with no external economic actors. Different types of crisis explanations are required, and two such mechanisms repeatedly occur in the relevant literature; systemic volatility of global imbalances and detrimental effects of global debt deflation. We will analyze both of them using the retroductive approach and assess their plausibility of being a cause for a global debt crisis. Simultaneously, we need to keep in mind the systemic crisis theory, features of the global monetary system, and MMT frameworks, where applicable.

6.1. GLOBAL IMBALANCES AND THE COLLAPSE OF THE U.S. DOLLAR

As we remember from chapter 3.3.2., there has been a long-lasting debate among economists about how profoundly the international monetary system is dependent on the global confidence in the U.S. dollar. The emerging consensus seems to be that, for the foreseeable future, the dollar effectively functions as a global reserve currency and, thus, guarantees the smooth functioning of our international monetary system. Even though many scholars have linked the

possible vulnerability of the dollar to the future of the American political power (e.g. Kirshner 2008), there have been multiple concerned voices warning about the threats a dollar-dominated system imposes on the stability of the global economy. The main threat, the argument goes, comes from global imbalances, where the ever-widening current account deficit (or increasing debt levels) of the dollar would become unsustainable in the long run. The IMF figures below show that the global imbalances have been indeed substantial, especially before and during the GFC. Note that the figure's percentages denote surpluses and deficits from the global GDP instead of the GDP of the respective regions.

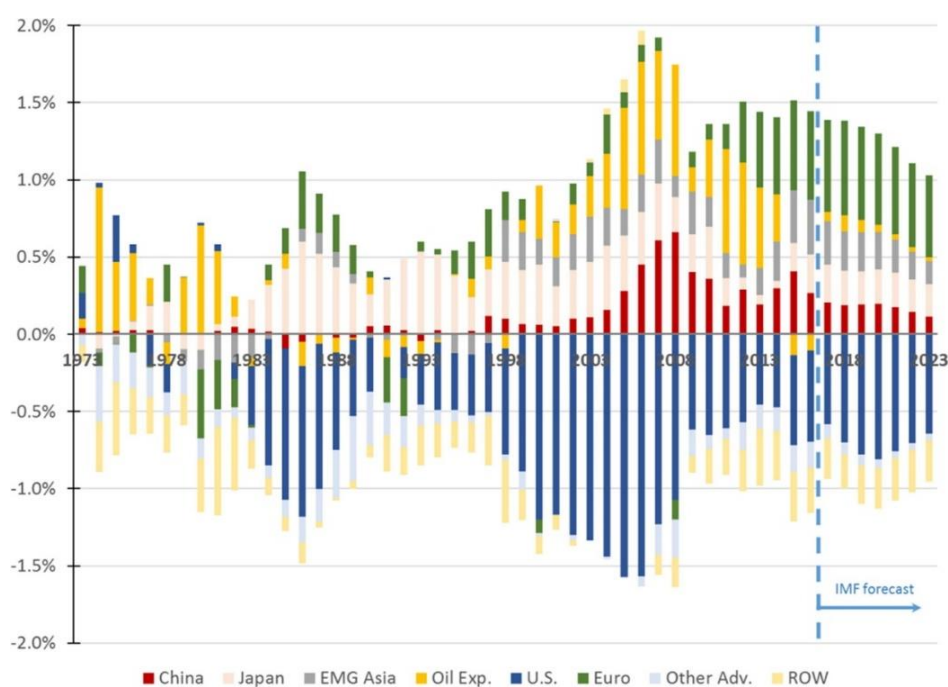


Figure 4. The current account balances of major economic areas 1973-2023⁵² (in % of the global GDP) (Ito and McCauley 2019).

How would global current account imbalances specifically lead to a debt crisis, meaning how they could function as a mechanism? Eichengreen, Mehl and Chitu have offered a clear summary of a possible chain of events in their work *How Global Currencies Work*, which is worth quoting in full:

“In an international monetary and financial system dominated by the dollar, the United States is essentially the sole supplier of the safe and liquid assets that central banks hold as reserves and commercial banks and corporations use as the risk-free bedrock of their portfolios. If emerging markets continue growing faster than the U.S. market, as the

⁵² The years 2017-2023 are an IMF estimate and do not necessarily correspond to the actual figures. For example, the effects of Covid 19-pandemic have certainly altered the picture for the years 2020-2021.

logic of convergence suggests, then their demand for safe and liquid assets will rise faster than **the capacity of the United States to supply them**, where that capacity is limited by the ability of the U.S. government to raise taxes and service the government debt securities that are held as reserves and used in cross-border transactions by other countries. The world will then be faced with a twenty-first-century version of the Triffin Dilemma. Either the United States will limit its issuance of debt securities, in which case other countries will be starved of international liquidity, or the U.S. government will increase issuance along with foreign demand, in which case confidence in its ability to service that debt, and therefore the safety and liquidity of the latter, will be cast into doubt.” (Eichengreen et al. 2019, 196-197, emphasis added).⁵³

In other words, the way for the global imbalances leading to a crisis depends on the global confidence in the international reserve currency issuer. The principal fear seems to be that foreign investors would stop financing the U.S. current account deficit, which would launch a downhill economic cycle, as Teunissen and Akkerman have argued: “In sum, the principal risk to global stability and thus to stability in emerging markets from the current pattern of global imbalances lies in the possibility of a disorderly correction that would precipitate a major slowdown in US growth and a significant rise in US interest rates.” (Teunissen and Akkerman 2006, 26). Because of the dollar’s role as a global reserve currency, the sudden rise in interest rates would be enough to create a global crisis in this scenario. Furthermore, because the underlying cause for the downhill cycle would be the excessive U.S. debt and the threat would be systemic, the chain of events would be precisely a global debt crisis of a systemic nature.

Eichengreen and his colleagues are not the only ones who have argued we are still suffering from a new version of the Triffin dilemma, where the creditors' confidence has taken the place of the gold standard as a critical systemic factor (e.g. Kregel 2009, 3). According to this view, the dangers of using national currency as an international one have not disappeared, only transformed. These dangers trace back to the dysfunctionality of the international monetary (non)system with no globally coordinated currency (Barredo-Zuriarrain 2016), where the United States again faces immense pressure to protect the dollar. However, without the restrictions of the gold standard, the monetary sovereign governments have a wider variety of tools to conduct active monetary policy.

⁵³ To avoid confusion regarding the other views expressed by Eichengreen throughout this thesis, we should note that this is just a summary of the argument made by those concerned about the modern-day Triffin Dilemma, not necessarily an endorsement of it.

The vulnerability of the United States has concerned macroeconomists at least since the original Triffin dilemma. Warnings of the dollar collapse because the U.S. massive twin deficits reached their apex in the years before the GFC. Economic historian Adam Tooze has called this predicting a ‘Wrong Crisis’ in his book *Crashed: How a Decade of Financial Crises Changed the World* (Tooze 2018, 25-41). In 2005-2007, American policymakers and economists were extremely worried that the dollar was vulnerable to bond market pressure and that the loss of confidence from those holding large quantities of U.S. Treasury notes (particularly China) could lead to a sharp depreciation of the dollar and a sudden hike in interest rates (ibid., 34-35). For many politicians and economists alike, the U.S. public debt was the crisis-triggering problem (Teunissen and Akkerman 2006; Bernanke 2007; Krugman 2007). As we now know, the financial crisis that was on the horizon during the years 2005-2007 was not a dollar crisis triggered by excessive U.S. sovereign debt but a large-scale banking crisis triggered by the private U.S housing market crash. Many economists were forecasting a crisis, but most saw it coming from the wrong direction.⁵⁴

Furthermore, with their work of key currency areas, Ito and McCauley have demonstrated that countries that had tied their currencies into the U.S. dollar were simultaneously offsetting the U.S. current account deficit with their surpluses during the years before GFC (Ito and McCauley 2019). Therefore, even though the United States was running large deficits, the dollar currency area was in near current account balance despite all the fears and warnings of the dollar collapse. This surprising notion reminds us of the limits of looking at global imbalances strictly from the national point of view instead of the currency-using areas. Let us now assess the concerns of those arguing for the global imbalances crisis scenario and whether it is probable or even plausible in the light of the earlier chapters.

6.1.1. ASSESSMENT OF GLOBAL IMBALANCES

Theory of global imbalances offers a straightforward and easily understandable mechanism for a global debt-induced crisis, which may be one reason why it became such a widespread prediction in the mid-2000s. It rests the blame strictly on the shoulders of one country, which has made it an easy rhetorical and political weapon both domestically and internationally. One

⁵⁴ One of the first economists to notice this was Bradford DeLong, who wrote about the wrong financial crisis already in 2008, see (DeLong 2008).

can quickly see how statements such as: “The US’s foreign debts pose a grave threat to the global economy because a point will arise when creditors lose confidence in the ability of the US to repay its debts” (Pettifor 2006, 98) can appeal to both domestic deficit hawks and opponents of American imperialism, depending on the situation. However, most of the issues we have covered in this thesis suggest a different situation.

The problem is that the entire case for the global imbalances hypothesis rests on the premise that the United States is fundamentally **unable** to issue currency through debt bonds or maintain confidence in the dollar as a safe asset, leading to the massive dumping of dollars from investors. From the framework of MMT, we notice quickly that the premise is incorrect in both accounts. The United States has the highest degree of monetary sovereignty where no external forces can prevent it from issuing currency, and the dollar’s reserve status guarantees that there will be demand for it in the foreseeable future. According to MMT, there is no threshold after which the confidence in the dollar would drop overnight since there is no danger of involuntary debt default for the United States. Furthermore, if confidence in the dollar would drop gradually, that would remove the main triggering factor from the crisis mechanism, namely the sudden interest rate hikes. The evident outcome is that global imbalances are not strong enough to cause a global debt crisis from the retroductive perspective. Despite the clear mechanism, the hypothesis of an imbalance-triggered crisis will fail since it rests on faulty premises.

The MMT economists are not the only ones to argue the unlikelihood of an imbalances-triggered crisis. Barry Eichengreen has concluded that the dollar is almost certainly not going to encounter an investor panic since, in a looming emergency, FED would surely step up to support the dollar by buying them directly from foreign exchange markets (Eichengreen 2011, 160-161). As in the case of the Euro Crisis in 2012, central banks would fulfil their roles as doing ‘whatever it takes’ to ensure financial stability. In the end, the confidence in the dollar depends much more on the U.S. domestic institutions than the whims of financial markets. Mainstream economists are also gradually noticing that the US is not the only country that is not punished for substantial current account deficits. As one recent IMF study notes: “...there is cross-sectional evidence that economies can take on much larger net international liabilities than the United States has done, without necessarily lowering their credit standing. In particular, Australia carries a substantially larger burden of net external liabilities than the US economy while retaining a top country and sovereign rating” (Bordo and McCauley 2019). From the perspective of MMT, this account is just another example of the fundamental principle of monetary sovereignty and its importance for currency-issuing countries such as Australia.

Even if we accept the Triffin Dilemma assumption that there is an inherent instability in using a national currency as a global currency, it does not automatically lead to any crisis, but at worst, merely increases its likelihood. Therefore, looking at the matter from the retroductive perspective, the requirements of capable and necessary reasons are not met since global imbalances will not constitute a situation without which crisis would not be able to exist. Naturally, none of this is to say that global imbalances cannot have other severe economic consequences or that we should pay no attention to them. One can make a good case for global imbalances' distorting effects on economic development across different regions, among other adverse consequences (Hudson 2009). However, when our focus is strictly on the global debt crisis, the conclusion must be that global imbalances are neither a sufficient cause on their own for such a crisis to come about nor even function as a significant contributing factor.

6.2. THEORY OF DEBT DEFLATION

Economist Irving Fisher formulated the first coherent debt-deflation theory in the 1930s to explain the severity of the Great Depression (Fisher 1933).⁵⁵ Fisher noticed that when the private sector becomes increasingly indebted, it needs to convey an increasingly large slice of its monetary flows to debt service. This phenomenon removes money from circulation, leading to deflation (falling commodity prices and increasing the value of money) on the overall economic level. According to Fisher, this may lead to a self-perpetuating cycle of debt crisis if the initial debt levels were too high:

“Each dollar of debt still unpaid becomes a bigger dollar, and if the over-indebtedness with which we started was great enough, the liquidation of debts cannot keep up with the fall of prices which it causes. In that case, the liquidation defeats itself. While it diminishes the number of dollars owed, it may not do so as fast as it increases the value of each dollar owed. Then, the very effort of individuals to lessen their burden of debts increases it, because of the mass effect of the stampede to liquidate in swelling each dollar owed.” (ibid., 344)

⁵⁵ Thorstein Veblen had formulated some principles of debt deflation in his *Theory of Business Enterprise* a few decades earlier. However, he had focused more on its effects from the perspective of a single business enterprise, see (Lucarelli 2012, 337-338).

In other words, this mechanism leads to a paradoxical situation where the more debtors pay their debts, the more they end up owing because the very act of paying the debts leads to deflation, which increases the real value of the remaining debt accordingly. Even though the process is a little more complicated in practice, the main effect is that price (and wage) levels fall. However, the debt levels stay the same, which is catastrophic for indebted businesses and individuals alike. Fisher saw this combined mechanism of rising debt levels and falling price levels as the essential factor that could prolong any large-scale financial crisis if the state does not apply any necessary countermeasures (ibid., 341). Instead, during the late 19th and early 20th centuries, states followed more or less the *laissez-faire* approach and let the debt deflation resolve itself through waves of bankruptcies prolonging the Great Depression.

Fisher's theory was based on limited data of financial crises and was made when the payments system was very different from our own (Shiller 2013, 2). Therefore, the continuing applicability of Fisher's theory has been debated for decades (e.g. Wolfson 1996) primarily because the recent financial crises have usually not been accompanied by falling price levels. Hyman Minsky provided a more modern version of the debt deflation process⁵⁶, which shifted the focus from falling output prices to falling asset prices. As he wrote about the mechanism: "Once a situation exists where debt payments cannot be made either by cash from operations or refinancing, so that assets have to be sold, then the requirements imposed by the debt structure can lead to a fall in the prices of assets. In a free market, the fall in asset prices can be so large that the sale of assets cannot realize the funds needed to fulfill commitments. When this happens, widespread insolvency results from systemic illiquidity." (Minsky 1994, 232). In effect, both versions of deflation leave companies unable to meet their debt commitments and may lead to a widespread financial crisis. The effects of debt deflation are made even worse if banks will curtail lending to indebted and desperate borrowers (as they often do in times of crisis) in the name of responsible finance (Wolfson 1996, 328-329). Moreover, the interdependence of the financial system would increase the contagion effect of deflation if the eroding trust leads to an even steeper fall of asset prices.

Since Minsky considered the capitalist financial system fundamentally unstable (see Minsky 2008), he did not believe that the private sector could ever break out from the debt deflation cycle by its own means. Individual economic interests will most likely clash with the stability

⁵⁶ Minsky wrote about the dangers of debt deflation already in his 1960s essay *Can "It" Happen Again?*, where he assessed the plausibility of a second Great Depression. Minsky kept revising his views on the issue during the following decades, see (Minsky 1982).

of the broader economy. Due to investors' herd behaviour, the market forces would simply sink deeper into the crisis when falling asset prices would keep profit-seeking capitalists from investing. These self-reinforcing negative cycles are at the heart of Minskyan theory of financial instability⁵⁷ (Lucarelli 2012). Instead, Minsky argued that averting the worst effects of debt deflation always required the stabilizing force of 'Big Government', which could ensure liquidity (Minsky 2008, 43-44). Even then, its intervention might not be enough, especially if the government's spending capacity was political or economically limited.

The mechanism of debt deflation has one crucial distinction with global imbalances. We note that the triggering factor for debt deflation is the indebtedness of the private sector, where the indebted actors usually have no other option than to pay their debt obligations in full. Thus, the systemic tendencies place the debt burden on those people for whom it is most difficult to bear. When an ever-larger slice of monetary flows is forced to go to debt service, the consequence is less money in circulation and the gradual suppression of economic activity.⁵⁸ Therefore, we can see that the debt deflation cycle offers a plausible systemic mechanism for launching and prolonging a financial crisis. However, the crucial question is whether it can produce a debt crisis that can threaten the entire global monetary system instead of merely causing problems to national economies.

6.2.1. DEBT DEFLATION ON A GLOBAL LEVEL

One can argue that our interconnected financial and banking system increases the chances of debt deflation having global effects, but the root of the problem might be even more systemic. Economist Michael Hudson has repeatedly issued stark warnings for the global debt deflation (Hudson 2009, 2014). From a Post-Keynesian perspective, he argues that the mainstream economists have downplayed the global impacts of rising debt levels because they believe economic growth should keep private debt as a productive force. Alongside other MMT economists, Hudson accuses neoliberal economists of getting the effects of debt backwards by being concerned about public debt and downplaying the adverse effects of private debt (Hudson 2014, 62). Instead, he argues that through the mechanism of compound interest, debt levels in

⁵⁷ Another classical account of the self-reinforcing boom-and-bust cycle leading to a financial crisis is found in (Kindleberger and Aliber 2011).

⁵⁸ Naturally, this description cannot cover all complexities of the debt deflation but merely summarizes the main point of it. For a more mathematical model of the debt deflation disequilibrium, see (Keen 2000).

the private sector tend to grow more rapidly than the economy's ability to carry them (ibid., 69-71). For Hudson, this growth leads to a paradoxical situation where the economy is at the same time inflationary and deflationary. Nearly unlimited credit pumps up the property and asset prices (inflation) as the financial bubble grows until it bursts and reveals the debt side of every credit, leading to income being absorbed to debt service instead of consumption or investment (deflation) (ibid., 275). The mechanism is essentially the same as Minsky's and other earlier academics'.

Hudson warns about the global threat because he argues that the debt-deflation mechanism is not restricted inside one national economy or economic region. Instead, it is happening everywhere in the private markets simultaneously due to the logic of capitalist accumulation. Hudson considers the deflation phenomenon a necessary systemic feature of contemporary capitalism, where increasing private debt burdens are inevitable. In the same vein, deflation is inevitable at some point because: "Debt service must be paid irrespective of price and income levels." (Hudson 2009, 256), meaning that there is a threshold after which the deflationary spiral is triggered. Therefore, debt deflation must always be combined with a triggering financial crisis that transforms the excessive private debt levels into a mechanism that worsens the crisis considerably. Its systemic nature makes the threat global. In effect, on an aggregate level, the debt service plays a similar deflationary role for Hudson as savings played for Keynes: an economic paradox that threatens the functioning of the entire system.

The severeness of global debt deflation comes from the fact that there is a vast power imbalance between private debtors and creditors. As critical commentators have noted: "Consumers have been forced into debt by creditor-imposed deflationary economic policies; those same policies will prevent them from getting out again." (Greenhill 2003, 45). Therefore, debt deflation becomes quickly a spiral where indebted consumers and businesses sink deeper and deeper alongside the broader crisis. Another grave consequence of debt deflation is its dramatic transfer of wealth from poorer debtors to richer creditors, known as the 'Hoover effect' (ibid., 34-35). Thus, on a global scale, debt deflation contributes heavily to the increasing inequality even if it would not threaten to disrupt the international monetary system.

An important point to remember when discussing debt deflation is the Post-Keynesian approach of money as credit. Ann Pettifor has argued that the root of the problem is the massive creation of private money that generates debts that cannot be repaid, but everyone continues behaving as if they could (Pettifor 2006, 83). Once again, the systemic problem is in the relation of a sum to its parts; every individual debtor can, in principle, meet its demands, but collectively

everyone cannot pay their debts. Therefore, the amount of money directed towards debt service is double destructive from the overall economic perspective. It siphons money away from the productive economy, and it can never lead to any desirable conclusion. Regardless of how legitimate the creditors interests are, even they should not turn a blind eye to the harmful effects of increasing debt service, especially in times of financial crisis.

In conclusion, Hudson ultimately argues for widespread debt cancellations, especially for regions and industries where the decline of debt service would generate a maximum amount of economic activity. In that regard, his views are similar to many other debt-critical scholars and practitioners, such as Susanne Soederberg of Kunibert Raffer; his focus is merely more on the debt-burdened private actors instead of countries in the Global South. Furthermore, Hudson's argument stands apart because he has justified his concerns by presenting a credible global mechanism for the dire effects of excessive private debt. For Hudson, the fundamental choice is between large-scale debt write-downs and continuing neo-serfdom of indebted people (Hudson 2014, 440). Therefore, we need to assess whether his gloomy predictions of the future of our financial system are inevitable or whether the principles we have examined earlier make other developments possible.

6.2.2. ASSESSMENT OF GLOBAL DEBT DEFLATION

The power of debt deflation as a mechanism comes from its fundamental connection with the functioning of the capitalist system. It is an inner systemic mechanism where a growing portion of monetary flows will shift into unproductive activity. According to the theory, nothing will stop the debt deflation cycle from transforming into a system-threatening debt crisis without outside intervention. Furthermore, the debt aspect of the crisis is emphasized since the root of the problem is excessive private debt and the inner logic of creditor power. From an MMT perspective, what really differentiates the public and private debt is that all private debts (however unreasonable) are expected to be repaid. In contrast, public debt needs to merely pay interest to bondholders (Hudson 2015, 409). That is the reason why debt deflation is a much more severe threat when private debt levels are high.

Therefore, the theory of debt deflation does not violate the frameworks of MMT. The private sector debtor cannot be monetary sovereign, and since most of the debt stays within the private sector, sectoral balances do not play a significant role in the situation. The logic of the debt

deflation cycle determines that it will affect all economic activity, and there is a decent chance it could drive the monetary system into a crisis that would threaten its existence. As such, the theory of debt deflation forms a much stronger hypothesis for a global debt crisis than the warnings about the effects of global imbalances. However, it still leaves a question open of whether it is a necessary cause for the global debt crisis to unfold.

The problem of the debt deflation cycle is that there seems to be no clear threshold to notice when the debt service starts the deflationary process. Hudson claims that the process is bound to start at some point, but he leaves the specifics too ambiguous. Suppose we follow Fisher's and Minsky's accounts instead. In that case, we see how the debt deflation process can exacerbate an ongoing financial crisis, but there is no certainty that it will cause a new one. Unfortunately, we do not have the means to determine when private debt and debt services have become excessive or when exactly the debt service starts to hinder economic activity too much. Furthermore, we cannot ignore the effects of political intervention or the role of changing assumptions. The threat of debt deflation only becomes significant if we stick to the idea that debts must always be fully honoured, no matter the circumstances.

Perhaps debt deflation is just another theory in the long list of claims that capitalism is nearing its inevitable demise. Many of its adherents seem to believe (or even hope) so, leading to somewhat overblown arguments. For example, one can argue that Hudson is taking a step too far by claiming that debt deflation leads to neo-feudalism, where we are all rentiers of the financial and banking class (Hudson 2012). His prediction is just one possibility among many trajectories in an open-ended future, not an inevitable path of financial doom.

We also need to remember that the issues of global imbalances and global debt deflation are not entirely separate, and they have been examined as mutually reinforcing contributors to financial crises (see, e.g. Guttman 2009). However, in this thesis, they have merited their own chapters because they approach debt crises from different directions, one from the public and the other from the private. In conclusion, debt deflation offers a more robust, albeit ambiguous, case for a coming global debt crisis. We can say that the debt deflation cycle represents one of the most plausible mechanisms for the global debt crisis. Using a retroductive approach, we can say it is capable of causing a systemic crisis, but calling it a necessary cause is more controversial. Only the future can tell us how and where the global debt deflation process will unfold or whether it ever will.

7. DISCUSSION – INDISPENSABILITY OF POLITICS

“One basic point in political economy has to be remembered. The phenomenon of borrowing—getting money today in exchange for money tomorrow—is economic. But how such transactions are managed is political.” (Strange 1998)

Susan Strange, one of the founders of the International Political Economy (IPE) discipline, always stressed the political nature of financial markets⁵⁹ and the relevance of power relations between different countries and market forces. For her, the ‘political’ always took precedence over ‘economical’ when examining international political economy. In the context of debt, she saw already in the 1990s the network of transnational debt obligations becoming too complex to govern effectively. Still, her answer to the question of whether they posed a threat to the international financial system remained inconclusive (ibid.). The debt architecture as such did not lead to a crisis; the leading question was about political power. Similarly, when we have examined possible mechanisms for the global debt crisis, the role of conscious political decisions keeps resurfacing. Most debt scholars at least acknowledge their importance, even if their emphasis is on the systemic features. Let us consider some examples.

For the MMT scholars, the political nature of debt is naturally integral. However, even most studies that approach the debt crisis from the perspective of mainstream economics acknowledge the crucial role of political decisions (Eichengreen 2011, 162-163; Stiglitz and Heymann 2014, 11-15; Kose et al. 2020, 182-183). Despite their heavy emphasis on economic forces, they never render politics entirely useless, even if its role is often reserved for mitigating the most severe effects of debt crises. For those accounts that aim to say something about the future prospects, the role of politics is usually the final arbiter: “Which scenario is more likely for the future? The answer is uncertain. It is for policy-makers and their publics to decide” (Eichengreen et al. 2019, 200). Ultimately, there is no escaping from political choices.

In critical accounts, the approach to debt is even more explicitly political as this quote from Susanne Soederberg shows: “...financial risks are historically specific social constructs that are used to discipline debtors through their real virtuality and through the material threat of withholding desperately needed funds.” (Soederberg 2005, 940). Furthermore, in his historical

⁵⁹ Her 1980s classic study, *Casino Capitalism* (Strange 1986), argued long before Ocampo for the idea that our international monetary system had become an uncontrollable non-system without any effective governance.

materialist approach, Jesse Hembruff has examined sovereign debt as a sort of ‘fictitious capital’ for which the international financial system and accompanying institutions give legitimacy (Hembruff 2013, 721-722). The hegemonical ideas also have their place in the debate. For example, Roos has pointed out the assumption that heavily indebted countries should always prioritize servicing their external debts has become an unquestionable international norm (Roos 2019, 298). The political choices determine the debt debate as much domestically as they do globally.

As a more practical example, we saw debt becoming political in the fall of 2021 when the U.S. Congress engaged again in a bitter debate about raising the debt ceiling to keep the Federal Government financed. The debt ceiling (or debt limit) is a political instrument created by the U.S. Congress that determines the maximum amount of outstanding debt the Federal Government can have (Rouse et al. 2021). Congress has repeatedly increased the ceiling when needed throughout the decades, which the deficit hawks in both parties have often opposed ferociously. The 2021 debt ceiling fight was unusually drawn-out, but, eventually, the matter was resolved without a government shutdown or the U.S. defaulting on its debts. However, according to the U.S. Secretary of Treasury Janet Yellen, the threat of default was genuine (Yellen 2021).

From the theoretical perspective of this thesis, the entire debt limit debate is a self-inflicted political obstacle. As we remember from earlier chapters, the monetary sovereign U.S. is never economically constrained to issue new debt if needed, and there is virtually no threat of investors abandoning the dollar-denominated debt. Therefore, some MMT scholars such as L. Randall Wray have called the debt limit outright crazy (Wray 2015, 6). Even though it is redundant in an economic sense, we can see how useful a political tool it can be. The debt limit removes the sovereign debt from being an economic necessity to an instrument of political negotiations. The irony is that in the name of ‘fiscal responsibility’, the deficit hawks are the biggest threat for the U.S. to being stuck with the debt ceiling and unable to create enough currency to meet its obligations. However, the resulting default would be entirely voluntary and politically created.⁶⁰ Barry Eichengreen has repeatedly stressed that: “The fate of the dollar is

⁶⁰ For the devastating effects of U.S. default, see (Schwarcz 2014). One notable controversy Schwarcz points out is that the default of the dollar might not even be constitutionally legal. Since most lawmakers are aware of the possible economic and legal calamities, they have always found some last-minute deal to avert a full default (though government shutdown has happened several times, most recently in December 2018). This brings up an interesting debate about the U.S. government priorities during budget negotiations that is unfortunately outside the scope of this thesis.

in our hands” (Eichengreen 2011, 177). The needless quarrel over the debt limit shows that his statement is correct, for better or worse.⁶¹

As much as wrong political decisions may lead to a self-reinforcing debt crisis cycle, right political decisions may create institutions that virtually eliminate the possibility of a system-threatening debt crisis. One underappreciated plan by Keynes during the Bretton Woods negotiations was establishing an International Clearing Union (ICU) to regulate the exchange between internationally used currencies. The function of ICU would have been to create a global bank and tie every foreign exchange rate to an international trading currency, ‘bancor’ (de Vegh 1943). This global currency arrangement would have facilitated global trade between currencies and effectively removed the need for countries to accumulate debts in foreign currencies. Therefore, the significance of global imbalances between currencies would have been minor if ICU had been tasked to monitor and regulate global monetary relations.⁶² In recent years, there have also been proposals to establish something similar at the European level to deal with the imbalances within the Eurozone (Whyman 2015). Another institutional example is that the severeness of debt deflation could be mitigated with both institutions that prevent predatory lending practices and basic income programs such as the proposed EU ‘helicopter money’ (Gali 2020), ensuring the financial flows turn into a productive economic activity. Ultimately, the only thing we are lacking in establishing crisis-preventing institutions is political will.

The ubiquitous nature of politics points to an exciting result. We established earlier using a retroductive approach that neither global imbalances nor global debt deflation are **necessary** mechanisms for a global debt crisis, even though debt deflation seems **capable** of producing one. Despite their widespread occurrence in the relevant literature, they usually need an additional mechanism to produce an existential systemic crisis. Indeed, political decisions seem to satisfy both criteria of retroduction. Misguided politics may very well drive currency-issuing countries into a self-inflicted crisis, and, ultimately, every plausible debt crisis mechanism depends on politics and political institutions. It functions as the causal link between structures

⁶¹ To illuminate how separated the debt limit debate has become from any fiscal issues is that there have been serious proposals for the U.S. circumventing the limit by issuing high-value platinum coins (or even just a few trillion-dollar coins) to pay the debt (Austin and Thomas 2017, 14-16). So far, the treasury has abandoned the idea. However, the mere possibility of this accounting trick shows that the debt limit question bears little relation to underlying economic activity and much more to its political feasibility.

⁶² Along with many other proposals put forward by Keynes, the U.S. prevented the establishment of the ICU primarily because they wanted to protect the dollar’s role as a reserve currency. Some of the initial functions of the ICU were transferred to IMF.

and events that Sayer was demonstrating.⁶³ This indispensability of politics offers an antidote to all economic models that predict an incoming inevitable global debt crisis or warn of the significant risk of one. In the light of the arguments of this thesis, politics is the mechanism of launching a global debt crisis as well as preventing one.

8. CONCLUDING REMARKS

"There is actually more debt in this world than there is money. So, it will probably get paid, as long as we borrow something from other planets. Now we have paid our debt, but we owe 10 billion to Jupiter!" (Leikola 2011)

The quote above is from Finnish comedian Ismo Leikola's stand-up show. It is fundamentally untrue, like all good jokes (it is questionable whether there is more money than debt in the world), but it also reveals some crucial truths. In this case, it is the ludicrousness of thinking debt in any other way than between humans and entities we have created that is on display. The joke reminds us that all of the world's debt is confined within the monetary system itself. There is no creditor of humanity besides ourselves, and only socially constructed institutions have the power to affect our collective debt. Nevertheless, to make matters more concrete, this thesis has focused on social scientific mechanisms and their role in pushing debt relations toward a crisis. The lesson learned is that, fortunately, no mechanism produces inevitable results in an open-ended social science since they can always be mitigated with appropriate counter-mechanisms. Therefore, no global debt crisis is unavoidable.

This thesis set out to examine two research questions; whether high debt levels could cause a global debt crisis and, if not, what mechanism might be capable of that. Based on a solid theoretical background and a comprehensive analysis of different possibilities, we can now summarize the concluding arguments. First of all, high debt levels cannot be sufficient for launching a global debt crisis since their role is different on a global level than on a sovereign or private level. Simply put, debt accumulation is rarely as dangerous for the global system as political commentators fear, and its existence is, in many cases, beneficial for the global economy. Secondly, the often suggested mechanisms of global imbalances and global debt deflation are alone insufficient to bring about a global debt crisis without explicit political

⁶³ See Figure 2. on page 13.

decisions to exacerbate their effects or, at worst, to cause a self-reinforcing cycle of debt. Furthermore, for the global debt crisis to happen, it requires political decisions not to respond to debt problems appropriately with counter-mechanisms such as central banks taking responsibility for the debt. The ultimate conclusion for this thesis is that a societal crisis, debt-induced or not, depends more on political factors than economic predictions.

Naturally, this thesis has been just a scratch off the surface for the issue as massive as global debt. Much more research is needed to uncover the global functioning of debt relations sufficiently. Even though MMT has done an admirable job of reorienting national debt models, its global recommendations still fall short. For example, we still lack a comprehensive global version of the Stock-Flow Consistent model, which would help us examine all global monetary flows and obligations in one framework. Furthermore, the MMT arguments based on monetary sovereignty (which this thesis also uses) would benefit from a more rigorous analysis of the different degrees of sovereignty between countries. Finally, examining debt relations from the global perspective needs better integration of political power in its approach. These recommendations would undoubtedly enhance our understanding of global debt even further.

As a final tentative suggestion, maybe we need to turn our attention to an altogether different kind of debt crisis. Since the 1990s, some environmental and political scientists have suggested that instead of financial debt, we should be worried about the ecological debt our way of life is creating. The most relevant distinction is that: “the ecological debt concept acknowledges the interconnections between society, nature and economy that are so often held as separate, irreducible objects within social science and policymaking” (Warlenius, Pierce, and Ramasar 2015, 28). Instead of focusing on purely monetary relations, ecologic debt returns the discussion into the real world and the planet we live on. In essence, ecological debt is a metaphor, a debt that future generations will have to ‘pay’ if we cause irreparable harm to our shared planet.⁶⁴ However, as a metaphor, it might show us a better direction for where the existential, systemic debt crisis is forming instead of our attention remaining in the monetary matters.

⁶⁴ As with the MMT's use of money as debt, we note that the ecological debt differs from the term's common usage as a financial obligation that needs to be repaid.

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