Part III

The contemporary world-economy
6. Markets and exchange
6.3 Debt crises in the modern world-system

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Introduction

This chapter deals with the world-system literature on global debt crises, that is, on situations where sovereign borrowers, mostly peripheral and semiperipheral countries, are confronted with debt-servicing difficulties and are forced to restructure the outstanding external debt owed to core lenders. The relevance of sovereign debt crises for world-system research arises from three kinds of interaction between external debt, and world-system dynamics and structures. Firstly, the evolution of global debt and financial crises is related to the general evolutionary dynamics of the modern world-system, that is, trends and cycles. Thus, global debt problems and financial crises have repeatedly occurred in the history of the modern world-system; several scholars have developed models of causal relationships between global debt cycles and financial crises, on the one hand, and long waves of economic growth and innovation, world leadership cycles and processes of state formation, on the other. Secondly, the evolution of the main structures of the modern world-system, the core/semiperiphery/periphery hierarchy, is linked to the processes of periphery indebtedness and debt crises. Thus international lending booms with flows of financial capital from the core to the periphery and the subsequent (periphery and semiperiphery) debt crises have contributed both to the integration of peripheral and semiperipheral regions into the world-economy as to the reproduction and deepening of the core-periphery hierarchy. Thirdly, debt crises impact on the evolution of international financial regimes and global financial governance. Thus, as a consequence of successive sovereign debt crises and debt restructurings, a global regime dealing with sovereign debt has gradually evolved over the past 200 years.

Since the global debt crisis of the early 1980s, there is a growing amount of literature, within and outside the world-system perspective, dealing with the dynamics, causes, and consequences of periphery indebtedness and global debt crises. This chapter focuses on four major issues that have been addressed by world-system research: Firstly, the historical evolution and dynamics of global sovereign debt booms and crises and their causal mechanisms; secondly, the economic, social, ecological, and political consequences and implications of debt dependence and debt crises; thirdly, the relationships between debt crises and world leadership cycles, and, finally, the evolution of a global regime dealing with sovereign debt problems. In what follows, the contribution of the literature to each of these four topics is described and discussed in more detail.
Global debt booms and global debt crises

There is a large body of literature dealing with the historical evolution and dynamics of international lending booms and global financial crises. The fact that sovereign debt crises have repeatedly occurred over the past centuries has already been mentioned in the pioneering works of Winkler (1933), Borchard and Wynne (1951) and Kindleberger (1978). Large-scale sovereign borrowing and great amounts of sovereign default and restructuring did not begin, however, until the early nineteenth century. This was linked, on the one hand, to the expansion of the international state system, that is, the increasing number of sovereign states, particularly the newly established independent states in Latin America, which considerably increased the number of potential sovereign borrowers. On the other hand, financial innovations and the development of international capital markets, contributed to the rise of sovereign debt from the early nineteenth century onwards. Accordingly, most of the literature discussed below refers to the era of industrial and financial capitalism, or to specific historical periods and debt crises within this era.

Worth mentioning in this regard are several studies in economic history published in the 1950s and 1960s dealing with particular historical debt crises or debt-service incapacities of specific debtor countries. In the context of this economic history perspective, the Atlantic economy approach was developed; its basic argument is that within the specific spatio-temporal framework of the Atlantic economy before World War I, cyclical fluctuations of external borrowing by less-developed and underpopulated debtor countries were (inversely) related to Kuznets cycles of domestic investment in the core countries.

In the wake of the debt crisis of the early 1980s, the literature dealing with the problem of periphery indebtedness and debt crisis soared (cf. Suter 1992 for an overview). Most of this literature is rather descriptive, limited to the developments of the late 1970s and early 1980s, confined to single aspects or specific cases, and often considering sovereign debt difficulties as isolated policy problems. However, more comprehensive and systematic approaches to the long-term evolution of periphery indebtedness and sovereign debt have been developed as well (see notably Pfister and Suter 1986, 1987; Eichengreen and Lindert 1989; Kowalewski 1989; Marichal 1989; Eichengreen 1991; Suter 1992, 2009; Reinhart and Rogoff 2009). The subsequent discussion focuses on these more comprehensive studies.

There is widespread agreement in the above-mentioned literature concerning the repeating phases of debt booms and debt crises and on the fact that all lending booms eventually ended in waves of debt-servicing incapacity on the part of sovereign borrowers (cf. Reinhart and Rogoff 2009; Suter 1992). The literature distinguishes nine phases of sovereign debt booms and global debt crisis that are summarized in Table 6.3.1. The extent of the respective debt booms and subsequent debt crises varies, and there is a shift in the geographical focus of sovereign debt crises: the European periphery and Latin America in the 1820s; the US states in the 1840s; the European periphery, the United States, and Latin America in the 1870s; Latin America and Southern Europe in the 1880s; Central and Eastern Europe and Latin America before World War I and during the 1930s; Latin America, the European periphery, and Africa in the 1980s; Eastern Europe, East Asia, and Latin America in the 1990s; and Eastern, Southern, and parts of Central Europe in the current financial crisis.

Table 6.3.1 Periodization of global lending booms and subsequent sovereign debt crises, 1820–2010

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Sources: Suter (1992, 2009).
While there is a consensus concerning the existence of these sovereign debt-boom-bust cycles, there is no agreement as to the causal mechanisms. Some authors (e.g., Aggarwal 1996) emphasize single factors like excess liquidity (for the explanation of debt booms), inefficient and consumptive use of foreign resources by debtor countries, external economic shocks, and credit rationing (for the explanation of debt crises). Others argue that lending booms and debt crises are causally linked (Eichengreen 1991; Kindleberger 1978; Marichal 1989; Reinhart and Rogoff 2009). Scholars in the tradition of the world-system perspective, however, favor structural and systemic arguments (Kowalewski 1989; Pfister and Suter 1986, 1987; Suter 1992; Thompson and Reuveny 2009). Thus, in my book Debt Cycles in the World-Economy (Suter 1992) I developed the concept of “global debt cycles:” these are characterized by consecutive phases of (1) global lending booms or expansion of foreign credits, (2) the outbreak of payment crises, and (3) the resolving of debt crises, that is, settlement between debtor countries and their creditors in the form of debt restructuring agreements. Besides the fundamental thesis that such global debt cycles exist, I argued that these sovereign debt-default-restructuring cycles are associated with global economic growth and innovation cycles within the framework of Kondratieff and Kuznets cycles, world leadership cycles, and secular trend movements, and lead to increasing institutionalization of international financial relations, as well as—on the level of peripheral and semiperipheral states—with the dynamics and the constellations of (domestic) political regimes.

Empirical analyses of the causal mechanisms of booms in periphery and semiperiphery indebtedness suggest that cycles in economic growth (both Kuznets and Kondratieff cycles) and liquidity in core capital markets are important factors (Kowalewski 1989; Marichal 1989; Suter 1992; Thompson and Reuveny 2009). In addition to economic factors, political factors also played an important role—for example, the decolonization of Latin America and the end of the Napoleonic wars in the early nineteenth century, the end of World War I with the German reparation payments that triggered the lending boom of the 1920s, the decolonization of African and Asian countries that was partly linked to the boom of the 1970s, and the collapse of communism in Eastern Europe that was closely associated with the boom of the 1990s. Additional explanatory factors (for the 1970s boom period) are foreign trade (export fluctuations), foreign direct investment dependency, investment rates and the presence of a development-oriented political regime.

Cross-sectional evidence for determinants of debt-servicing incapacity suggests that debt crises are triggered by a combination of several factors (Reinhart and Rogoff 2009; Sturzenegger and Zettelmeyer 2006; Suter 1992; Thompson and Reuveny 2009 for an overview): first, declining export revenues (due to the collapse of prices for major export commodities, terms-of-trade deterioration, and economic recession in core countries); second, deteriorating prospects of economic growth; third, rising interest payments and/or increasing costs of external borrowing; and fourth, a stop or reduction in new lending by creditors and declining liquidity in international capital markets. This last factor (credit rationing), however, seems to play only a minor role. Furthermore, debt-servicing performance in the past remains an important determinant (after controlling for the other explanatory factors). In addition to these economic factors, political factors played an important role as well. Thus, World War I and revolutions triggered the debt crisis of 1915–22 (defaults by Austria-Hungary, the Ottoman Empire and Bulgaria and by Mexico and Russia, respectively).

**Consequences of debt dependence and debt crises**

Since the mid-1980s, the economic, social, and political consequences and implications of debt burden and financial crises were increasingly debated. Two interrelated factors contributed to the rising interest of world-system scholars in these topics.
Firstly, several scholars claimed that the boom of core lending and of external borrowing by peripheries and semiperipheries had fundamentally changed the structure of economic dependence. Thus, they maintained that traditional forms of economic dependency characterizing core-periphery relationships during the 1960s and 1970s (trade, foreign direct investment) were increasingly replaced by foreign debt dependence—such as, for instance, debt burden, stocks of external debt, or debt restructurings and the corresponding creditor-mandated structural adjustment programs. These new dependency structures were expected to adversely affect the economic, social, and ecological development of periphery debtor countries.

Secondly, the debt crisis of 1982–83 was not overcome rapidly but turned out to be rather protracted, particularly in Latin America, Africa, and Eastern Europe. The governments of the heavily indebted countries were forced to adopt structural adjustment programs and austerity measures implemented in the context of the multilateral debt restructuring regime of the Washington Consensus (IMF conditionality). These politics of adjustment also influenced the research agenda of development studies, international political economy and world-system studies that increasingly began to explore the structural adjustment programs’ economic, social, political, and ecological effects.

In the context of the world-system perspective, four topics were of particular interest: (1) the effects of debt and debt crises on economic growth, and the relationship between debt dependence and traditional forms of economic dependency; (2) the consequences of debt and structural adjustment for quality of life, social development, and sustainability; (3) the impact of debt restructuring and structural adjustment on political protest and the mobilization of anti-systemic movements; and (4) the relationship between debt crises and the evolution of domestic political regimes.

The first group of studies that empirically explored the relationships between trade, foreign direct investment and foreign debt dependence, as well as their impact on economic growth, was inspired by the debate on the (negative) growth effects of foreign direct investment in peripheral countries (e.g., Bornschier and Chase-Dunn 1985). Pfister (1984) and Rothgeb (1984, 1986) found a positive relationship between the penetration of transnational corporations and debt dependence; Rothgeb argues that the repatriation of profits by private foreign capital in the manufacturing sector, in particular, contributed to the accumulation of external public debt. Several studies empirically investigated the impact of external debt on growth: most of them found negative growth and development effects, although these often varied according to the type of debt and the geographical region of the debtor country and/or country group. Stocks of non-concessional external debt vis-à-vis private creditors and IMF-imposed austerity measures, in particular, were negatively related to economic growth (Bradshaw and Huang 1991; Bradshaw and Wahl 1991; Glasberg and Ward 1993; Pfister 1984; Pfister and Suter 1986, Przeworski and Vreeland 2000).

The second group of cross-national studies extended the analysis of the developmental consequences of external debt by focusing on the social and ecological dimensions of development and underdevelopment (basic needs’ satisfaction, poverty, physical quality of life, life expectancy, infant mortality, school enrollment, deforestation). Their results, however, are mixed depending on the dimensions of social development. Thus, while Bradshaw and Huang (1991) and Bradshaw and Wahl (1991) report non-significant relationships between foreign debt and IMF conditionality on the one hand and physical quality of life on the other, Sell and Kunitz (1986), Bradshaw et al (1993), Buchmann (1996), Schafer (1999), and Burns (2004) found generally negative effects on educational enrollment and the survival of children, particularly concerning IMF conditionality. Similarly, studies exploring the effects of debt crises on sustainable development showed mixed results. Thus, the findings of Marquart-Pyatt (2004) suggest no
relationships between debt and deforestation, whereas according to Shandra et al (2008) debt dependence and IMF conditionality both negatively affect natural forest areas. The more recent analysis of Shandra et al (2004) suggests interaction effects of political democracy, that is, the deleterious effects of debt crises are particularly harmful in countries with low levels of democracy. In addition to these quantitative studies using a cross-national research design, a large number of case studies demonstrated the social and environmental costs of structural adjustment programs (e.g., George 1992).

The third topic concerns the effects of the global debt crisis on political processes in peripheral and semiperipheral countries. The important study by Walton and Ragin (1990) focuses on impacts on political protest. The authors demonstrate that IMF conditionality (but not debt dependence) is an important predictor of the occurrence and severity of social unrest, political protest, and political violence. This confirms the results of other studies showing similar mobilization effects of economic dependence (e.g., for foreign investment, London and Robinson [1989]; Rothgeb [1996]). Another important topic addressed by many studies during the 1980s and 1990s was the impact of the debt crisis on domestic political regimes and political transition (and vice versa the impact of the type of political regime on the implementation of debt restructuring and adjustment policies). This particularly concerns the discussion in Latin America, Africa, and Eastern Europe, where processes of democratization and regime change evolved parallel to the debt crisis. Several studies highlight the variety of domestic political regimes, the importance of starting points and trajectories (i.e., “path dependency”) and the autonomy of political processes (for Latin America, cf. Stallings and Kaufman [1989]; Suter [1999]).

Debt crises and world leadership cycles

World leadership cycles or hegemonic sequences refer to the cyclical rise and fall of hegemonic core powers. Several scholars argued that periphery and semiperiphery indebtedness and debt crises are related to the functioning of world leadership cycles (see notably Rasler and Thompson 1983; Thompson and Reuveny 2009). In my book Debt Cycles in the World-Economy (Suter 1992), I hypothesized that during hegemonic sequences debt problems are moderated (since the hegemonic power acts as an international lender of last resort) and that debt settlements are more efficient but less favorable for debtor countries. A similar argument has been developed by Reuveny and Thompson (2004). The empirical analyses presented by Suter (1992, 2009), Reuveny and Thompson (2004, 2007) and Thompson and Reuveny (2009) clearly confirm these relationships. Thus, based on annual data from 1870 to 1989, Reuveny and Thompson (2004) and Thompson and Reuveny (2009) demonstrated that debt problems increased with declining world leadership, rising conflict between core countries, and declining world economic growth. Furthermore, several studies on sovereign debt restructuring showed that the crisis settlement was quickest during periods of hegemonic leadership, particularly during the US-dominated post-war period in the context of the restructuring regime of the Washington Consensus, but also (although less pronounced) during the British hegemony between 1870 and World War I (Kamlani 2008; Suter 1992, 2009).

The evolution of a global debt restructuring regime

One fundamental issue in the analysis of sovereign debt problems is the question of exactly how debt crises have been settled. When a debtor country is forced to suspend interest and/or amortization payments, the originally established loan contract between core creditors and periphery debtor country is unilaterally violated. The settlement of debt-servicing incapacity
therefore implies a restructuring of the outstanding debt, that is, a renegotiation of the loan contract.

As demonstrated by Suter (1992) and Tomz (2007), the great majority of these restructurings were negotiated within the context of cooperation and formal agreements between creditors and debtor countries. These agreements dealt with the settlement of arrears of interest payments, the renegotiation of interest rates and amortization payments, the reassessment of the outstanding debt and/or of the face value of foreign bonds, and finally, the provision of collateral (for future interest and amortization) payments. The legal and political background of these debt settlements reveals the lack of an international bankruptcy law for sovereign debt and the corresponding contractual enforcement mechanisms, analogous to bankruptcy procedures that exist at the national level (i.e., the principle of sovereign immunity).

The world-system and international political economy perspectives have a particular interest in analyzing the evolution of sovereign debt restructurings, since this process concerns patterns of creditor-debtor and core-periphery cooperation and the issue of (global) financial governance and/or international regime formation. The analysis of sovereign debt and debt crises from the perspective of international cooperation and regime building received growing attention from the mid-1980s onwards (Biersteker 1993; Helleiner 1994, 2005, 2006; Kamlani 2008; Lipson 1985; Pfister and Suter 1987; Porter 1993; Roodman 2001; Soederberg 2005; Tomz 2007; Wood 1986). Only a few of these studies, however, have attempted to develop a long-term perspective dealing with the evolutionary and structural dynamics of a global sovereign debt restructuring regime (see notably Pfister and Suter 1987; Tomz 2007; Kamlani 2008; Suter 2009).

Based on the data and analysis of Suter (1992, 2009), Soederberg (2005), Sturzenegger and Zettelmeyer (2006), Tomz (2007), and Kamlani (2008), the evolution and institutionalization of global sovereign debt restructuring regimes can be described in five consecutive phases, characterized by different degrees of how creditor coordination and cooperation are institutionalized: (1) the weakly institutionalized debt restructuring regime lacking creditor coordination in the early nineteenth century; (2) the debt restructuring regime based on the British Corporation of Foreign Bondholders increasingly institutionalizing creditor cooperation, combined with a high level of sanctions by creditors (1868–1925); (3) the debt restructuring regime based on the US Foreign Bondholders Protective Council decreasing the degree of institutionalization of creditor cooperation and with a low level of sanctions by creditors (ca. 1925/45–ca. 1960); (4) the multilateral debt restructuring regime of the Washington Consensus characterized by high institutionalization and strong creditor coordination within and between creditor clubs, as well as with international financial institutions (ca. 1960–98); and, (5) the post-Washington Consensus regime based on (neo-liberal) market-based debt restructurings (Collective Action Clauses) and decreasing institutionalization of creditor coordination (1999–2008).

A preliminary empirical analysis of the outcome of debt restructurings presented by Suter (2009) demonstrates that the efficacy of the crisis management and the degree of debt relief granted by creditors is related to the strength and the degree of institutionalization of creditor cooperation. Highly institutionalized creditor cooperation (1868–1925 and 1960/70–1998) generally results in more efficient debt restructuring and minor concessions in favor of debtor countries. The new market-based debt restructuring regime of foreign bonds that evolved in the early 2000s, however, seems to be more efficient than expected. This surprisingly efficient pattern of sovereign bond restructuring may be explained by the fact that the seemingly uncoordinated take-it-or-leave-it regime is still embedded in the larger cooperative framework of the Washington Consensus.

An open question is how the regulatory reforms proposed and discussed in the wake of the current international financial crisis will impact on the global debt restructuring regime. The establishment of an international debt restructuring court, as recommended by the 2009 Stiglitz
Commission, seems unlikely. The recent experience of the Greek and Irish debt restructurings rather suggests more decentralized, regional solutions.

**Concluding remarks**

Sovereign debt crises only became an important issue in world-system analysis from the mid-1980s onwards. Over the past 20–30 years, there has been a certain thematic shift from analyzing crisis mechanisms and the long-term historical dynamics of debt crises (mainly during the 1980s and early 1990s), to dealing with the consequences of debt dependence and debt crisis (mainly during the 1990s), and to dealing with the management of debt crises and global financial governance (1990s and 2000s). This debate has greatly improved our understanding of the modern world-system in three important respects: Firstly, it has provided detailed knowledge of the cyclical pattern of debt crises and its causal relationship with the dynamics of world economic growth and hegemonic leadership and challenged, from the very beginning, the implicit assumption of most (non-world-system) analysts that debt crises are singular (i.e., non-systemic) phenomena. In addition to new theoretical insights into world-system dynamics, this research has provided remarkable new historical data and time series on sovereign debt and debt crises that has inspired research far beyond the world-system perspective (cf. the recent work of Reinhart and Rogoff 2009). Secondly, it has demonstrated the relevance of debt-related dependency for the reproduction of the core/periphery hierarchy and thus considerably added to our understanding of these processes. Thirdly, it has provided insights into the evolution of a global debt restructuring regime and its relationships with world leader leadership cycles.

Despite these advancements, the potential of world-system research on debt crises has not yet been fully exploited. Three topics would particularly merit further research.

A first direction for future research concerns the systematic examination of the long-term consequences of the different responses to debt crises for the evolution and consolidation of different development models. As mentioned in Section 3, debtor countries differently responded to debt crises and differently implemented restructuring and adjustment policies—despite the seemingly uniform recipes ordered by core lenders and global governance institutions (like the “orthodox” IMF austerity measures and in the context of the multilateral debt restructuring regime). Debt crises seem to be crucial moments where the future development model and the prospects of a given debtor country are redefined. Analyses on the relationship between debt and development trajectories may significantly contribute to the recent discussion on the evolution of variants of capitalism at the periphery and semiperiphery.

A second topic for future research refers to the relevance and the impact of sovereign debt crises at the core of the modern world-system. Historically, sovereign debt crises have principally broken out in peripheral and semiperipheral states which have been hit most often and most hard by debt problems. The current financial crisis and the subsequent sovereign debt crisis, however, not only originated in the core, but also most severely affected core countries (together with Eastern and Southern European, and Latin American semiperipheries). These peculiarities might have an important impact on the working mechanisms of current and future debt cycles.

Closely related with this specificity of the current debt crisis is a third underresearched topic, namely the impact of the current financial and sovereign debt crisis on the structure of global financial governance. As hypothesized above in Section 5, important transformations are taking place in the global debt restructuring regime as a result of the current financial crisis. Thus policymakers of the crisis-affected core countries responded to the financial and sovereign debt crisis in a different, that is, in a much more interventionist way than they recommended to the periphery and the semiperiphery during the crises of the 1980s and 1990s. This contributed to the collapse of the
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neo-liberal consensus and the partial disintegration of the multilateral debt restructuring regime. Thus, although the IMF could, thanks to the crisis, overcome its severe weakness of the early 2000s, it has not (yet) become the leader defining the agenda of new global regulation. Rather, an informal and more decentralized system of global financial governance, characterized by different regional practices and limited regulative bodies, seems to be emerging in the wake of the 2008–09 crisis.

References