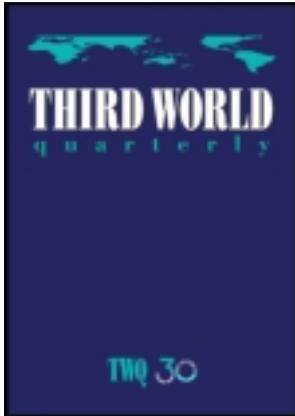


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### Recasting the Power Politics of Debt: structural power, hegemonic stabilisers and change

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# Recasting the Power Politics of Debt: structural power, hegemonic stabilisers and change

ANDREAS ANTONIADES

*ABSTRACT* The 2007–08 financial crisis exposed and exacerbated the debt pathologies of the West. This paper examines whether the new global debt relations that have been generated by this crisis have transformed global power politics, changing the way in which the global South and the global North interrelate and interact. To do so the paper analyses the G20 advanced and emerging economies, examining a number of key indicators related to debt, indebtedness and financial leverage. This research leads to two main findings. First, the crisis has indeed given rise to new global debt relations. As a result, any reforms in the post-crisis global political economy will take place in an environment that favours the rising powers. Second, the USA maintains its capacity to control the parameters of this new global debt politics and economics, but cannot directly impose the terms of a solution to the existing ‘global/hegemonic imbalances’ on the rising powers.

The evolving global economic crisis has forcefully shaken the foundations and parameters of the existing ‘international order’. Whether the present crisis episode is a manifestation of a broader hegemonic transition process, or of a milder rebalancing act with no hegemonic implications, remains to be seen. Put differently, only time will tell whether the current crisis will function as a ‘pressure valve release’ for the benefit of the existing order or as a catalyst for a different world order.<sup>1</sup> In any case, the impact of the crisis on the existing world order is inexorably related to the way in which the social agents and the social collectivities involved in these social fermentations will respond to and handle this crisis and the challenges, opportunities and threats generated by it.

This paper attempts to assess the impact of the current ‘global relations of debt’ on US hegemony and through this on the current global economic order. In this attempt our main concern is not with debt as an economic phenomenon that can be modelled and analysed in separation from (international) socio-political relations and power, but with debt as a socio-political relation and power.<sup>2</sup> Along

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these lines our main interest is to examine the way in which debt affects current great power politics and the position of rising powers within it. Our driving question is whether the current global relations of debt have transformed the way in which great power politics materialise in the global political economy.

### **The view *ex ante*: reversed Keynesianism and financial engineering**

In a paradoxical way the global economic crisis that started with the collapse of the subprime market in the USA in 2007 gave an answer to the pre-crisis ‘million-dollar question’: *who owns the debt?* Before the start of the crisis, the new ‘originate and distribute’ banking model, assisted by Special Purpose Vehicles (SPVs), financial innovation and soft-touch regulation seemed to have achieved the impossible. Risk was spread so widely and thinly that it disappeared. Magic(al) indeed; and the countries where this magic ruled were the countries that demonstrated strong and sustained economic growth rates.

Of course, the rising level of private, especially household, debt in these economies was a matter of concern. But the argument went that to grasp this phenomenon one should come to terms with a ‘new political economy of credit’, ie the different way in which contemporary economies function. Several arguments were raised in this regard. Excessive ‘plastic money’ may indeed be a liability and a threat to the economic system. Yet what was happening in these economies was that ‘plastic money’ was translated into real growth rates. Put differently, plastic money increased consumption, which in turn generated production and growth rates that led to increased employment, which, with new ‘real money’, boosted production and the real economy. Thus, what started as ‘virtual and plastic’ ended up as ‘real and productive’. Plastic money was translated into new employment, production and growth. This, of course, made Keynesian sense too. However, this time the role of the ‘booster’ was not played by the state but by the market. Consequently it was not ‘public’ but ‘private’ debt that was accumulated for the purposes of the ‘Keynesian operation’. As Colin Crouch has put it, the new political economy of credit was nothing more than a new privatised Keynesian model;<sup>3</sup> a ‘new Keynesianism’ for a globalised neoliberal world.

The collapse of the subprime market in the USA in 2007 supplied an answer to the question of ‘who owned the debt’ of the privatised Keynesian period, or more accurately, who would pay for it. When the magic disappeared (as magic does) and the ‘securitised layers’ started to fall apart like playing cards, public authorities stepped in. The Lehman Brothers episode was the ‘crossing-the-Rubicon’ point in this regard. In a spectacular move the collapsing Western financial system was *de facto* ‘nationalised’ and trillions of virtual dollars that were recycled through its complicated infrastructure were turned into public liabilities. The rest of the world watched the developments in the West with shock and awe.

Crises such as the current one are not unknown or unprecedented in world economic history. Rather the opposite. The current crisis seems to be just one more episode in the way in which the modern capitalist system has evolved.<sup>4</sup> Yet, despite the striking similarities among all past capitalist crises, these crises differ in their geopolitical and geo-economic implications. To assess the latter,

one needs not only to be aware of the structural and systemic causes of these recurrent crisis episodes, but also of what is distinctive about each crisis and how these distinctive elements matter and operate in each unique historical conjuncture.<sup>5</sup>

### **Distinctive elements of the current debt crisis**

In one of the most perceptive analyses of the current crisis, Barry Gills argues that the uniqueness of the current crisis is based on its multiple and diverse nature. This is an economic crisis that takes place in tandem with a hegemonic transition crisis; both these crises are taking place in the context of and are conditioned by an unprecedented environmental crisis. This ‘triple conjuncture’ generates historically unique crisis conditions.<sup>6</sup>

Furthermore, an element that clearly differentiates the current historical economic context from past ones is the level of financial integration in the world economy. The contemporary global economy is characterised by an unprecedented level of international capital market integration, an unprecedented level of financialisation, and an unprecedented penetration of financialisation techniques in people’s everyday lives. These phenomena have not only created a crisis-prone international economic system that facilitates ‘globally synchronised’ downward economic spirals,<sup>7</sup> but have also penetrated and destabilised national and international commodity and food markets, endangering the livelihood of people around the world.<sup>8</sup>

The current crisis is also unique in a number of ways that relate to global debt relations and dynamics. The pattern of the global distribution of deficits and surpluses (what is usually referred to as ‘global imbalances’) is a key issue here. Although the crisis led to an increase in debt levels almost everywhere, the main ‘victims’ in terms of mounting debt levels have been the advanced economies. The public debt to GDP ratio in the Group of 20 (G20) advanced economies of 64% in 2006 is expected to approach 110% in 2013. It is projected to maintain this upward route at least until 2015. The respective figure for the emerging G20 economies in 2009 stood at 38% (having fallen from its post-Asian crisis historical high of 71%).<sup>9</sup> As Reinhart and Rogoff note, from the 20th century onwards, the only time in history in which the advanced economies registered higher public debt levels was in the mid-1940s, when they were absorbing the impact of World War II.<sup>10</sup> Further, if we add household and corporate debt to public debt, the debt levels of the advanced economies is even higher in historical terms, approaching on average 315% of their GDP (see below).<sup>11</sup> And these historically high debt levels are combined with interest rates that are at a 200 year low.<sup>12</sup>

The other side of this rising indebtedness of the advanced economies is the direction of the current account imbalances. In the current financial crisis net savings and surpluses are not moving from ‘advanced’ to ‘emerging’ economies (as under the ‘gold standard’ and in the 1990s), or from ‘advanced’ to ‘advanced’ economies (as in the financial crises of the 1980s), or from ‘emerging’ to ‘emerging’ economies (as in the 1970s). For the first time in modern economic history, surpluses are moving from ‘emerging’ to ‘advanced’

economies, ie the ‘periphery’ is bailing out the ‘centre’.<sup>13</sup> In this sense any reforms in the world economy triggered by the crisis (will) take place in a context of global current account imbalances that favours the emerging economies. Furthermore, these imbalances are at a historical high as a percentage of world GDP (close to 6% at the end of the 2000s), a fact that strengthens further the position of rising powers in the current conjuncture.<sup>14</sup> The pattern of distribution of surpluses and deficits comes to strengthen this view. The degree of concentration of deficits in a single country, the USA, is historically unprecedented. In 2008 the US current account deficit accounted for the 75% of world current account deficits or, put differently, the USA absorbed roughly 75% of world net savings. At the same time the high number of countries with large current account surpluses (above 9% of GDP) is also striking in historical terms. In 1985 only three countries accounted for 50% of world surpluses, and they were all advanced (Japan, Germany and the Netherlands), whereas in 2005 the number was five and included representatives from BRIC and the oil-producing countries (Japan, China, Germany, Saudi Arabia and Russia).<sup>15</sup>

Finally, the composition of generated debt in the current episode diverges from past crises too. In the current crisis the debt of the non-financial corporate sector either did not increase significantly or in some cases decreased. In contrast, the amount of household debt rose to levels never seen in the past, while the sharpest increase in debt was registered by financial corporations.<sup>16</sup> The cases of Iceland and Ireland are exceptional but indicative. In Iceland the financial sector debt reached 580% of the country’s GDP in 2008, pushing the total debt to GDP ratio to an astronomical 1189%. The respective financial sector debt in Ireland in 2008 was 421% of the country’s GDP, whereas the total debt to GDP ratio in the country the same year was 700%.<sup>17</sup>

### **The West under the debt microscope: total debt and debt thresholds**

As in most similar cases in the past, most of the attention in the current crisis has been paid to the level of the public debt and to a lesser extent to the debt of the financial sector.<sup>18</sup> Yet, by focusing on public debt without accounting for private debt, one lacks an accurate picture not only of how leveraged an economy is (and thus how fragile its economic situation is and how difficult the deleveraging phase will be), but also of the real degree of indebtedness of an economy and its people. This is especially so given that, as we mentioned above, one of the distinctive characteristics of the current crisis are the high levels of household indebtedness. Therefore, in comparison to ‘public debt’, a more appropriate figure to capture real levels of national indebtedness is the ‘total debt’, a figure that consists of both the public and private debt (private debt includes that of households, the corporate non-financial sector and the financial sector).

At the beginning of 2011 the ranking of advanced G20 economies in terms of total debt to GDP ratio was the following: Japan (512%), the UK (507%), Spain (363%), France (346%), Italy (314%), South Korea (314%), the USA (279%), Germany (278%), Australia (277%) and Canada (276%), while the average for advanced economies was 339%. The contrast with BRIC’s total debt

is striking. In 2008, China's total debt to GDP stood at 159%, Brazil's at 142%, India's at 129% and Russia's at 71%.<sup>19</sup> Nevertheless, it should be emphasised that different economies are implicated in different debt equations. The fact that Greece's total debt to GDP ratio in 2011 was just 267% is indicative of this (but also of how misplaced a simplified moral discourse on nations' indebtedness can be). The key issue here is above what limit debt ceases to be a force for economic development and becomes a drag on growth. Based on the relevant literature, Table 1 offers a mapping of the diversity of debt problems within the group of advanced G20 economies. It is indicative that all G20 advanced economies have crossed at least two debt thresholds.

Last but not least, we should address here the potential duration of the crisis. Based on the analysis of past debt crises, Reinhart and Rogoff estimate that debt reduction and deleveraging takes on average about seven years. Consequently they suggest that the 10 years from 2008 to 2017 will be described in the future as 'the decade of debt'.<sup>20</sup> A similar thesis is advanced by Roxburgh *et al.*<sup>21</sup> Analysing 32 past debt and deleveraging episodes they found that the deleveraging process lasted on average six to seven years, while on average the debt to GDP ratio declined by around 25%.<sup>22</sup>

TABLE 1. Varieties of debt and thresholds of debt sustainability: the case of advanced G20 economies (Q2, 2011)

Public debt threshold range: <sup>1</sup> 60–90% of GDP	Household debt threshold range: <sup>2</sup> 80–85% of GDP	Corporate debt threshold range: <sup>2</sup> 80–90% of GDP	Financial sector debt threshold: <sup>3</sup> 82% of GDP				
Japan	226	Australia	105	Spain	134	UK	219
Italy	111	UK	98	France	111	Japan	120
France	90	Canada	91	UK	109	France	97
Germany	83	USA	87	S. Korea	107	S. Korea	93
UK	81	Spain	82	Japan	99	Australia	91
USA	80	S. Korea	81	Italy	82	Germany	87
Spain	71	Japan	67	USA	72	Italy	76
Canada	69	Germany	60	Australia	59	Spain	76
S. Korea	33	France	48	Canada	53	Canada	63
Australia	21	Italy	45	Germany	49	USA	40

*Note:* Cells in grey demonstrate values that exceed debt sustainability thresholds. Cells in dark grey demonstrate value above the upper estimates, whereas light grey cells demonstrate value above the lower estimates of debt sustainability thresholds, as suggested in the literature.<sup>1</sup>Based on C Reinhart & K Rogoff, 'Growth in a time of debt', *American Economic Review*, 100(2), 573–578, 2010; C Reinhart & K Rogoff, 'A decade of debt', *National Bureau of Economic Analysis Working Paper*, 16827, 2011; S Cecchetti, G Stephen, M Mohanty, F Zampolli, 'The real effects of debt', *BIS Working Papers*, 352, September 2011; M Caner *et al.*, 'Finding the tipping point – When sovereign debt turns bad', *World Bank Policy Research Working Paper*, No. 5391, 2010; J Elmeskov & D Sutherland, 'Post-Crisis Debt Overhang: Growth Implications Across Countries', Reserve Bank of India Second International Research Conference, Mumbai, February 2012; and the EU Stability and Growth Pact. It excludes the OECD (2012) estimate of 50%. For developing countries see Development Finance International, *Fiscal Sustainability of Debt*, Commonwealth Secretariat, London, April 2009.

<sup>2</sup>Based on Cecchetti *et al.*, 'The real effects of debt'; and the EU macroeconomic imbalances scoreboard.

<sup>3</sup>Average of advanced G20 economies, excluding the UK.

*Source:* Unless otherwise indicated above, the table is based on data presented in C Roxburgh *et al.*, *Debt and Deleveraging: Uneven Progress on the Path to Growth*, McKinsey Global Institute, January 2012.

Yet the distinctive elements of the current debt crisis may prolong and complicate the debt reduction and deleveraging process. Most past deleveraging episodes were significantly supported by an increase in net exports that helped boost growth rates in deficit economies.<sup>23</sup> Currently it is highly unlikely that all the deficit and highly leveraged states will be able to increase their exports simultaneously. If they try to do so, a serious negative backlash in terms of international development and poverty, and environmental degradation is almost certain, along with increasing trade frictions between export-oriented rising powers and advanced economies.<sup>24</sup>

Another significant factor that distinguishes the current crisis from past ones is the narrow state 'policy margin', because of the size of public debt. Partly as a result of the aforementioned contraction in GDP and partly because of states' effort to mitigate the negative impact of the crisis on the population, public debt is expected to rise for several years after the start of a financial crisis. In past crises this rise was on average 75% of GDP,<sup>25</sup> but pre-crisis public debt levels were much lower in comparison to the current crisis and thus the after-crisis public debt explosion was easier to handle. This time the crisis broke out at a time when the levels of public debt in advanced economies were already excessively high. This means that states' capacity to mitigate the social and economic impact of the crisis is much more constrained, and thus the impact of the crisis on the social fabric may spiral out of control.<sup>26</sup>

Demographics should also be mentioned here as an important negative contingent factor in this process of debt reduction and deleveraging. The population ageing that is observed in many advanced economies constitutes a challenge for public finance for it increases public expenditures and reduces public revenues, producing serious challenges for national pension systems. It makes debt reduction more difficult and fiscal sustainability more unpredictable.<sup>27</sup>

Thus policy responses in the current crisis take place in a rather uncharted environment.<sup>28</sup> Even if the worst is avoided (eg collapse of the eurozone, uncontrollable social unrest, disintegration of the international trade regime, competitive devaluations, etc), the need to reduce public debt and return to sustainable public finance will force Western states into low growth rates in years to come.

### **Debt as external dependency**

A critical aspect of the global politics of debt is whether debt is external or internal.<sup>29</sup> Put differently, it relates to whether the government (and the private sector) (re)finance their debt through internal or external borrowing.<sup>30</sup> A high percentage of external debt in an economy implies more dependency on its external debtors (official or private) as well as higher vulnerability to adverse changes in the external economic environment.<sup>31</sup> External debt was crucial, for instance, in the debt crises in Latin America in the 1980s, in East Asia in the 1990s and in the recent Greek debt crisis.<sup>32</sup>

Table 2a shows the levels of external debt in the G20 economies. At the beginning of 2012 the external debt to GDP average for the 10 advanced

TABLE 2. External debt, short-term external debt and net international investment position in the G20 economies

a: External debt indicators			b: Net international investment position	
2012, Q1	External debt % GDP	Short-term external debt % external debt	% GDP 2011	
China <sup>^</sup>	5.0	63.3	Japan	+54.0
Argentina*	7.6	2.2	Germany	+35.6
Saudi Arabia?	19.0	na	China <sup>1</sup>	+23.7
India*	18.2	4.2	Argentina*	+12.7
Brazil*	17.4	1.7	Saudi Arabia*	+107.3
Mexico	26.4	5.1	Russia* <sup>2</sup>	+1.0
South Africa	29.2	5.4	Spain	-92.5
Indonesia	26.6	4.4	Australia*	-57.8
Russia	27.7	3.7	Turkey	-47.7
South Korea*	34.9	11.9	Indonesia*	-40.4
Turkey	43.0	12.2	Brazil	-33.3
Japan	52.9	39.5	Mexico	-32.6
Canada	68.6	22.3	Italy	-22.3
Australia	87.8	22.4	South Africa*	-17.5
USA	100.2	43.1	USA*	-17.0
Euro area*	120.0	na	France	-16.5
Italy	119.6	38.2	UK	-14.1
Germany*	159.4	53.7	India*	-13.0
Spain	166.5	60.9	Euro area	-12.7
France*	191.7	72.0	Canada	-12.5
UK	418.7	297.9	South Korea	-9.0

<sup>^</sup> Data for 2010—source: World Bank; author's calculation

\* Data for 2011, Q4

\*Data for 2010

<sup>1</sup>Excluding Hong Kong (which is +287.7).

<sup>2</sup>From +7.9 the previous year.

Source: IMF (unless otherwise indicated).

economies was 118% (95% excluding the UK), whereas the respective ratio for the 10 emerging economies was 24.4%.<sup>33</sup> The difference in the external indebtedness between the two groups is striking. The percentage of short-term external debt of most G20 advanced economies is also striking. Short-term external debt multiplies the exposure and vulnerability of externally indebted economies.

Yet the external debt indicator accounts only for the non-equity state liabilities (it does not for instance account for foreign direct investment (FDI) or portfolio equity) and therefore it offers only partial information about the external economic position and dependency of a country. To have a complete picture of an economy's balance sheet of external financial assets and liabilities, ie to examine whether a state is a net global creditor or debtor, we need to examine its net international investment position (NIIP). Table 2b focuses on the NIIP of

the G20 economies. Interestingly only six G20 economies had positive net foreign asset positions (ie they were global creditors) in 2011. These included four emerging economies—Saudi Arabia, China, Argentina and Russia—and two advanced economies—Japan and Germany. All the 14 other G20 economies were net global debtors. Furthermore, the most unsustainable NIIP (in terms of net foreign liabilities as a percentage of GDP) were held by Spain (-92.5%) and Australia (-57.8%), followed by Turkey (-47.7), Indonesia (-40.4%), Brazil (-33.3%) and Mexico (-32.6%). Notable is also the fact that the net international investment position of the USA is much better in comparison to its position in the world current account balance (ie the picture emerging from ‘global imbalances’)<sup>34</sup>. Nevertheless, the difference between the G20 advanced and emerging economies remains. In 2011 the advanced G20 economies as a group had a negative NIIP of \$1.6 trillion, whereas the emerging G20 economies as a group had a positive NIIP of about \$342 billion.

If we translate the above data into absolute numbers in dollars, then the list of largest global debtors and creditors in 2011 is as shown in Table 3. It is important, however, to note here that a positive NIIP does not necessarily imply a declining external debt. A country may accumulate foreign assets through current account surpluses, thus building a positive NIIP, but may remain a net debtor in terms of its debt stock.<sup>35</sup> Indeed, overall, in 2010 the external debt of G20 emerging economies rose by \$340.7 billion, representing 68.8% of the combined stock of all emerging countries’ external debt.<sup>36</sup> However, this does not seem to significantly affect the solid global economic standing of the G20 emerging economies.

Table 4 demonstrates that, in 2010, the stock of BRIC’s external debt remained moderate, on average 17.5% of their gross national income (the respective figure

TABLE 3. Largest global debtors and creditors: G20 and other selected countries (US\$ billion based on NIIP 2011)

Global debtors			Global creditors		
1	USA*	2470.9	1	Japan	3255.4
2	Euro area	1543.1	2	China	1774.7
3	Spain	1284.1	3	Germany**	1335.5
4	Brazil**	818.0	4	Switzerland	937.1
5	Australia*	794.9	5	Hong Kong (PRC)	702.7
6	Italy	455.8	6	Singapore*	528.8
7	France	426.4	7	Saudi Arabia*	483.6
8	Mexico**	402.0	8	Netherlands	283.0
9	Turkey	381.1	9	Argentina*	46.2
10	UK	327.6	10	Russia*	15.7
11	Indonesia*	289.3			
12	India*	223.0			
13	Canada	209.7			
14	Korea**	126.8			
15	South Africa*	70.4			

Notes: \*Data for 2010; \*\*Data for 2012/Q1.

Source: IMF

for all developing countries was 21%). The same year, BRIC's short-term debt was 28% of their overall external debt (although this figure comes down to 21% if we exclude China). Yet the risks and vulnerabilities that are associated with this rather high short-term external debt have been significantly mitigated by BRIC's international reserves, which on average in 2010 stood at 210.6% of their overall external debt stock (103.8% if we exclude China's 531.2%) (see Table 4). At the same time in 2010 international capital flows to developing countries increased by 68% in comparison with 2009, thus returning to their pre-crisis 2007 levels. A significant part of this increase concerned debt-related inflows (both short-term related to trade, and public and private bond issuance), which increased by 200% in comparison with 2009.<sup>37</sup> There was also a considerable increase in inward FDI (27%) and portfolio flows (17%) but it was more moderate. These data indicate that 'global capital markets' look at emerging markets as a safe investment alternative to the embroiled European financial markets.

Our analysis up to now seems not only to uphold the argument of a new debt politics in the international system, but also to indicate that the rising powers have a solid standing in the new global debt dynamics. Rising powers seem to come out ahead of the game in debt politics, and this increases their policy options, space for manoeuvre and ability to promote and defend their interests in the global economy. In some sense, however, the terrain in which debt politics takes place remains a Western one. The next section focuses on structural and hegemonic 'rents' that the West, especially the USA, is able to extract in the current international system, and assesses their impact on the global politics of debt.

TABLE 4. Net debt inflows in selected G20 emerging economies, US\$ billion (unless otherwise indicated)

	Net debt inflows 2009	Net debt inflows 2010	Short-term to external debt stock (%)	External debt stocks to exports (%)	External debt stocks to GNI (%)	Reserves to external debt stocks (%)
China	43.5	120.9	63.4	28.9	9.3	531.2
Russia	-19.1	14.0	10.1	79.8	26.9	124.6
Brazil	30.4	78.5	18.9	143.9	16.9	83.2
India	18.4	38.6	19.4	80.9	16.9	103.5
Turkey	-13.8	27.7	26.6	184	40.4	29.3
Mexico	8.9	29.4	19.5	62.7	19.5	60.3
Indonesia	14.6	14.5	17.5	101.3	26.1	53.7
Argentina	-2.3	17.1	27.4	152.1	36.1	40.8
South Africa	-2.5	2.1	27.2	43.3	12.7	97
BRIC	18.3	63	28	83.4	17.5	210.6
(average)						
Developing countries (average)	-	495	25	69	21	137

Source: Author's compilation of data from World Bank, *Global Development Finance: External Debt of Developing Countries*, Washington, DC: World Bank, 2012.

### Exorbitant privileges and hegemonic stabilisers

To assess the real degree of dependency and vulnerability of the largest global debtors, along with the size and length of maturity of their external debt liabilities, we need also to account for the currency composition of these liabilities.<sup>38</sup> The larger the percentage of debt liabilities denominated in foreign currencies, the larger the risks involved and the greater the possibilities for negative external shocks. Table 5 demonstrates that the USA (and the major European countries) borrow essentially in their own currency. Between 80% and 90% of the US external debt is denominated in US dollars. The respective figure, on average, for the public debt of the largest eurozone member states is 98.7%, and for the UK 100%. In contrast, the rising powers' public debt is overwhelmingly denominated in foreign currencies. In particular, the average for the G20 emerging economies included in Table 5 is 97.6%, which is about the same with the BRIC average (97.4%), whereas the developing states average is slightly smaller at 92.5%.<sup>39</sup> Thus not only is the external debt of the major G20 advanced

TABLE 5. Currency composition of public and publicly guaranteed (ppg) debt\*, 2010 (unless otherwise indicated), as a % of ppg debt (unless otherwise indicated)

	Debt denominated in foreign currency <sup>3</sup> (%)	The three most important currencies in which ppg debt is denominated (excluding SDR) (%)
USA <sup>1</sup>	7.9	na
Germany <sup>2</sup>	2.4	na
France <sup>2</sup>	3.1	na
Italy <sup>2</sup>	0.2	na
Spain <sup>2</sup>	1.0	na
UK <sup>2</sup>	0.0	na
Russia	98.7	\$: 94.5 / €: 3.5 / ¥: 0.4
India	95.5	\$: 71.4 / €: 3.7 / ¥: 19
Brazil	97.2	\$: 86.0 / €: 6.1 / ¥: 5
China	98.2	\$: 84.0 / €: 6.9 / ¥: 7.3
Indonesia	95.6	\$: 51.8 / €: 8 / ¥: 34.7
Mexico	100	\$: 85.8 / €: 6.4 / ¥: 6.1
Turkey	99.6	\$: 63.8 / €: 31.1 / ¥: 4.5
South Africa	95.8	\$: 80.4 / €: 15.4 / ¥: 0
All developing countries	92.5	\$: 69.4 / €: 12.7 / ¥: 10.4
East Asia and Pacific	94.0	\$: 62.8 / €: 5.7 / ¥: 25.5
Europe and Central Asia	97.5	\$: 73.1 / €: 21.5 / ¥: 2.9
Latin America and Caribbean	97.8	\$: 84.5 / €: 8.9 / ¥: 4.4
Middle East and North Africa	81.8	\$: 42.5 / €: 30.5 / ¥: 8.8
South Asia	71.3	\$: 60.4 / €: 4.9 / ¥: 6.0
Sub-Saharan Africa	74.4	\$: 56.8 / €: 15.1 / ¥: 2.3

Notes: \*The ppg debt is the external long-term public and publicly guaranteed debt.

<sup>1</sup>Gross external debt on 30 June 2012—source: US Treasury. The table does not include a 12.1% of external debt which is declared by the US Treasury as 'unknown' in its composition.

<sup>2</sup>General government debt at the end of 2011—source: European Central Bank.

<sup>3</sup>Author's calculation based on World Bank's currency composition data.

Source: World Bank, unless otherwise indicated.

economies shielded by exchange rate and interest rate fluctuations, but they also control the currency (exchange rate, interest rates, quantity) in which the overwhelming majority of all other states borrow.<sup>40</sup>

Of course, this applies primarily to the USA. Having a significant part of its foreign liabilities denominated, and therefore due and repayable, in its own currency, the USA, in theory and in practice, can ‘export’ US inflation (ie print dollars) and ‘import’/‘acquire’ products, services and foreign assets. This renders a US balance of payment crisis almost impossible—indeed an exorbitant privilege. But it is more than that. It gives to the USA the equivalent of the ‘red button’ (nuclear launch key) in the nuclear balance of terror of the cold war period. Access to the red button allowed the USA (and the USSR) to negotiate, set and control the parameters of the Cold War. Respectively, the dollar allows the USA to be at the centre of and control the dynamics and parameters of global debt politics. Considering, moreover, the currency composition of the rising powers’ external debt, the USA will continue to exercise this privilege in the foreseeable future.

Paradoxically the current global crisis, if anything, further strengthened the international role of the dollar. The currency of the largest debtor in the world emerged as the only ‘safe heaven’, in investment terms, in the international economic system. Indeed, whereas before the European debt crisis most investors used the euro to diversify their dollar-dominated portfolios, after the European crisis there has been a clear move away from the euro and either back to the dollar (in most regions) or towards the yen (especially in East Asia and the Pacific).<sup>41</sup>

This hegemonic position of the USA in the world economy arms the country with further structural side-advantages in the changing global debt politics. Specifically the USA is able to extract side (valuation) rents and benefits that positively affect its foreign assets and wealth, and thus its net international investment position.<sup>42</sup> The rest of this section focuses on this issue.

The current account (CA) measures annual changes (flows) in the NIIP (stock) of a country. Thus, *ceteris paribus*, annual changes in the national CA balance equal annual changes in the national NIIP. A deficit in the annual CA demonstrates a country that needs to borrow from abroad and the amount of this borrowing corresponds to the amount of deterioration in the country’s NIIP during the same period. A surplus in the annual CA demonstrates a country that lends money abroad and corresponds to the amelioration in the country’s annual NIIP. In practice, however, these two figures (CA and annual change in NIIP) are rarely the same. This is the result of what is referred to as ‘valuation changes’. That means that, regardless of any newly acquired foreign assets or claimed liabilities (eg FDI, portfolio investments) reflected in the annual CA, the value of the existing assets and liabilities (the stock that the NIIP represents) may change. Thus, in practice, annual changes in the NIIP equal annual changes in the CA (flows) *plus* changes in the valuation of existing assets and liabilities (stocks) (for instance because of inflation or exchange rates changes; see below). When this valuation effect is negative, a country may run a CA surplus in a given year, without this being translated into a corresponding annual improvement in its NIIP. This happens because its CA surpluses are counterbalanced by a decrease in the value of

its foreign assets over the same year in which it ran the CA surpluses. The opposite is also possible. A country may run a CA deficit without this being translated into an equivalent deterioration of its annual NIIP, because its foreign assets may have appreciated over the same period of time. The latter is exactly what has been happening in the USA since the beginning of the 2000s, when its CA balance started to deteriorate swiftly.

In particular, although the USA ran CA deficits above 4% of its GDP throughout the period 2002–07, reaching a record high 6.1% of GDP in 2005 and 2006, the USA's NIIP over the same period registered a minor increase. As Schmitt-Grohe and Uribe calculate, during the period 2002–07, the USA registered

a cumulative deficit of 3.9 trillion dollars, or 32 percent of GDP. Nevertheless, the net international investment position increased by 0.08 trillion dollars...a huge discrepancy of almost \$4 trillion between the accumulated current account balances and the change in the NIIP...Without this lucky strike, the US net foreign asset position in 2007 would have been an external debt of about 43 percent of GDP instead of the actual 13 percent.<sup>43</sup>

Along similar lines Cline has estimated that during 2002–04 'seven-eighths of the US imbalance in current transactions with the rest of the world...was in effect obtained for free because of huge favorable asset valuation changes'.<sup>44</sup> For the period 1991–2004 Cline estimates that the valuation benefits for the US NIIP in absolute terms reached \$1.26 trillion.<sup>45</sup>

The valuation impact of the financial crisis that followed the subprime crisis is equally telling with regard to the nature of global debt relations. After having registered a significant increase in its NIIP (3% of GDP) in 2007 (while the same year its CA deficit was above 5% of GDP), in 2008 the USA experienced a spectacular decrease in its NIIP of 13.7% of its GDP (combined with a CA deficit of 4.7% of GDP). More interestingly, however, this negative shock was followed the subsequent year (2009) by the largest annual increase in its NIIP (above 10.6% of its GDP), at least since 1979, combined with a CA deficit of -2.7% of GDP.<sup>46</sup> The gap between CA and NIIP remained significantly positive for the USA in 2010 (roughly -3% and -0.5%, respectively). Thus, valuation changes in 2008–10 far overshadowed the negative impact of CA deficits on the US NIIP.<sup>47</sup>

It is more than evident from the above data that the USA has demonstrated a unique capacity to reduce the negative impact that persistent current account deficits have on the international position and economic sustainability of any country. As Cline argues, 'what the US NIIP loses from annual current account deficits, it has tended to gain back at least partially through valuation effects... [T]he US could be said to have been able to devalue away a significant part of its external debt'.<sup>48</sup> To describe this phenomenon, researchers have used expressions such as 'borrowing without debt',<sup>49</sup> 'debt without pain' or 'free debt'.<sup>50</sup> Yet most analysts agree that this position is not sustainable in the medium to long term.

According to official US Bureau of Economic Analysis data these valuation effects take place through three distinctive channels as discussed below.<sup>51</sup>

*Exchange rate valuation*

While the great majority (almost entirety) of US foreign liabilities is denominated in US dollars, the great majority of the US foreign assets is denominated in foreign national currencies.<sup>52</sup> Therefore, any depreciation of the dollar towards the currencies of countries where the USA holds foreign assets leads automatically to an increase in the value of these assets (since local currencies appreciate towards the dollar and the US assets are denominated in local currencies). Thus any depreciation of the dollar increases the value of the US foreign assets, while leaving relatively unaffected the value of its liabilities. Taking into consideration that for most of the period after the beginning of the 2000s the dollar has been depreciating significantly (above 20%) in real effective terms towards most main foreign currencies of relevance to the US NIP, it is clear that this channel has allowed the USA to generate huge capital gains able to offset significantly the negative implications of its rapidly deteriorating current account balance over the same period.<sup>53</sup> Furthermore, taking into consideration that the USA can, to a considerable degree, exercise control over the international value of the US dollar (both through monetary, interest-rate and foreign economic policies), this valuation channel is the channel which the official US policy apparatus can control the most.

*Asset price valuation*

There are at least two aspects of asset price valuations. The first relates to the type of which the US foreign assets and liabilities consist. In particular, the majority of US foreign assets are in equity-type investments, FDI and portfolio equity (high risk–high returns), while the majority of US liabilities are in debt obligations, mostly bonds (low risk–low returns). Consequently the value and valuation of US foreign assets depend on fluctuations in international stock prices (measured in US dollars), while the value of US bonds remains rather stable and the official US policy apparatus maintains interest-rate policy as a means to influence them. Thus, in conditions of international economic stability (real or illusory—see the ‘great moderation’ period), when international stock markets tend to be stable or move upwards, the capital gains extracted from the US foreign assets (FDI and portfolio equities) outperform by far the US debt liabilities. Considering the strengthening of the place of rising powers in the global economy, this pattern of returns is likely to continue in the foreseeable future.<sup>54</sup> Of course, this valuation effect is moderated or reversed in periods when international stock markets are plummeting. Nevertheless, in this latter case a reverse of financial flows back to the USA mitigates this negative valuation impact.

The second aspect with regard to asset price valuation concerns the dynamic of the relationship between US foreign equity assets (FDI and portfolio equities) and US foreign liabilities in respective equity-type investments (ie the US foreign liabilities that do not concern debt obligations). Here the direction of the valuation effect (positive or negative) depends on how the US stock market performs in relation to international stock markets. When the US stock market

outperforms its competitors, the value of US liabilities (US equity owned by non-US investors) increases (ie there is a negative valuation effect for the USA), whereas when stock markets internationally, for instance in rising powers, outperform the US stock market, the value of US foreign assets is boosted (positive valuation effect for the USA). The latter has been the case since 2002 and continued to be the case after the start of the global economic crisis.<sup>55</sup> Furthermore, although valuation effects coming from diverse stock market performances should not be exaggerated,<sup>56</sup> in the ‘decade of debt’ that the West is going through this channel will most probably continue to produce positive valuation changes for the USA.

#### *Other and residual valuation*

This channel has sparked great debate in the literature.<sup>57</sup> Since the beginning of the 2000s, the positive valuation impact coming from this channel on the US external position has been significant (at times equivalent to the positive effect from the exchange rate valuation). There is no agreement, however, about whether this positive valuation impact comes from unrecorded or mis-recorded financial flows (FDI or portfolio equity), problems in the measurement of the stock of assets and liabilities, or unaccounted (or not easily accountable) capital gains from intangible US assets, often referred to also as ‘dark matter’ (eg export of business and management know-how and brand name value).

Of course, valuation effects are not exclusive to the USA. They can and do occur in all countries. This is most evident with regard to exchange rate valuation changes. As shown above, the external debt of most countries is not only denominated in different currencies, but is also expressed or measured in US dollar value. Thus fluctuations in the value of the US dollar and other external-debt-related currencies automatically produce valuation changes for the countries involved. For instance, whereas in 2011 the US dollar depreciated against the currencies of Brazil, China, Japan, Mexico, South Korea and South Africa (thus producing positive valuation changes for the USA), it appreciated against the Indian rupee (thus producing positive valuation changes for India).<sup>58</sup> In particular, for the period between the end of March 2011 and the end of December 2011, this dollar appreciation produced a positive valuation effect on Indian external debt of \$12.2 billion. Thus, whereas without the valuation effect the Indian external debt at the end of 2011 would have been \$ 347.1 billion, the valuation change brought this number down to \$334.9 billion.<sup>59</sup>

Nonetheless, the multiplicity of the valuation channels described above demonstrates that the case of the USA with regard to valuation changes is unique both quantitatively and qualitatively. From the above analysis it is evident that, thanks to the international role of dollar, the degree of the international economic integration of the US economy, and overall its central and hegemonic place in the global economy, has at its service a unique range of structural and institutional mechanisms that function as ‘automatic stabilisers’ not only for the sustainability of its external position but also for its broader hegemonic role in the international economy. And this is without including the

role, effect and influence of the USA in the organisations and institutions that define the existing international economic architecture (IMF, World Bank, G20).

To conclude, the analysis of valuation effects demonstrates the multiplicity and complexity of the channels through which the USA has been able to ‘devalue away’ a significant part of its external debt over the past decade. For this reason these valuation mechanisms are a critical aspect of the current power politics of debt.

### **In the final analysis, agency matters as much as structure**

In our preceding analysis we have tried to assess the implications of the global economic crisis that broke out in 2007–08 in terms of new global debt relations, dynamics and dependencies. We have also attempted to examine less apparent aspects of this global debt architecture which manifest the structural power of the USA, as well as ‘structural biases’ embedded in the existing structure of the world economy that favour the reproduction of the existing global politico-economic order.

However, it would be a mistake to take the impact of the current crisis on the USA, China, the EU and the other major politico-economic players as given. The impact that the crisis will have on the major global politico-economic actors and their relations is not independent of the way in which these actors have tried and will try to deal with the ongoing crisis. Put differently, the impact of the crisis on each actor depends critically on the policies and strategies that each actor itself deploys and has deployed in order to overcome the crisis. The case of the eurozone is a pointed example. The handling of the Greek issue in 2009 mutated into a national debt crisis for Greece, which itself mutated into a debt crisis for the eurozone’s periphery, spread into Italy and Spain, and has threatened to bring about the collapse of the euro and the eurozone. Thus, a crisis that originated in the USA and could have been used as an opportunity to strengthen the international role of the EU and its common currency led in exactly the opposite direction. It has proved damaging both for Europe’s international image and role and for its internal cohesion and integration dynamics. Primarily this is a result of the way in which the EU itself responded to the crisis.

The response to the crisis is also critical because it determines how long it will take for each actor to exit the crisis and at what cost. Here, one should be very cautious with forecasts and generalisations. Yet the evidence presented hitherto seems to support overwhelmingly the thesis of a decade of debt and debt adjustment for the West, specifically the USA and the EU. One lesson drawn from past debt crises in advanced economies is that the mode of deleveraging is key for a return to a sustainable economic path. For instance, not dealing in time and effectively with bad, non-performing loans clogs the financial system and undermines its stability and credibility. The longer the problem remains unresolved, the longer it takes for a return to a sustainable growth path. For instance, in Japan the failure, for almost a decade after the burst of the real estate and stock market bubbles in 1989, to deal effectively with its overleveraged corporate sector has been an important factor behind the country’s inability

to overcome its economic crisis during the past two decades.<sup>60</sup> Of course, international currency politics and the appreciation of yen after the Plaza Accord, is also critical for understanding the ‘Japanese malaise’.

In the current debt crisis and in terms of deleveraging the USA seems to have taken a much more resolute stance in comparison with the EU. As Roxburgh *et al* demonstrate,<sup>61</sup> since the end of 2008, ‘all categories of US private-sector debt have fallen as a percent of GDP’. The largest reduction was registered in the financial sector, where by mid-2011 the ratio had fallen below where it stood in 2000—a reduction estimated in absolute terms at \$1.9 trillion.<sup>62</sup> The respective reduction in US household debt was about \$0.6 trillion.<sup>63</sup>

On the other hand, a deleveraging equivalent to that seen in the USA is still pending in the EU and eurozone. Based on past debt crises this probably indicates that the eurozone has been left behind in terms of returning to a sustainable economic path, and thus its debt crisis may take more time and resources to overcome. This is despite the fact that the EU, at the time of the start of the crisis had, and still has, better economic fundamentals in comparison with the USA. A prolonged crisis in the European economy, however, cannot but have a negative impact on the US economy and its adjustment process. In such a scenario, in which a prolonged European ‘economic malaise’ drags down the USA and its economic recovery process, the result would be an acceleration of the geopolitical and geo-economic implications that are nested in the new global debt relations described above. Whether this happens, only time will tell.

### Conclusions

It is a mistake to treat the ‘West’ and the ‘global South’ as single entities. Yet our analysis has shown that there are significant differences in the debt and external positions between the G20 advanced and emerging economies, that these differences produce historically unprecedented global debt relations in favour of rising powers, and that there is no easy or fast (peaceful) way for the advanced economies to overcome the negative implications of the current crisis and reverse the existing current account flows and dependencies.<sup>64</sup> In this sense, the post 2007–08 global debt relations breed the potential of geopolitical and geo-economic transformations. Our analysis, however, has also demonstrated that the West and especially the USA maintains sufficient structural power to control the parameters of any significant change in the global political economy. Controlling these parameters, however, is not the same as deciding the content and agenda of the global political economy. Our findings suggest that the need to deleverage and re-base the Western economic system on a stable foundation, so as to restore its sustainability, will not only take time but, most importantly, is a game that the West has to play from a position of weakness (excessive leverage and indebtedness, eurozone crisis), at least in comparison with its traditional post-World War II status.

In this environment the rising powers can and have strengthened their presence and voice within the Bretton Woods system (eg enhanced role of the G20, redistribution of voting rights in the IMF). In this way the system is becoming more representative and a decoupling of the ‘global South’ is less likely.

After all, this system has served as the ladder used by BRIC themselves, especially China, to emerge.<sup>65</sup> But no significant geopolitical changes seem to be on the way. The most significant change brought about by the new global debt politics and economics concerns the very resolution of the debt crisis itself. In past episodes, hegemons would resolve ‘global imbalances’ (see hegemonic imbalances) by imposing their will and a self-beneficial solution on all the other stakeholders (through political pressure, threats, promises, sanctions or gunboats). Currently, the USA seems no longer to be in a position to impose its terms on the rest of the world. In this sense the rising powers seem to have gained a new space of policy autonomy.<sup>66</sup> What this space will be translated into depends on both structure and agency.

## Notes

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- 18 Data from C Roxburgh, S Lund, T Daruvala, J Manyika, R Dobbs, R Forn & K Croxson, *Debt and Deleveraging: Uneven Progress on the Path to Growth*, McKinsey Global Institute, January 2012. Roxburgh *et al* quote as their source Haver Analytics, national central banks and the McKinsey Global Institute. With regard to this comparison of debt levels, it has to be noted that the debt and leverage capacity of emerging

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