

INTRODUCTION

The Sovereign Debt Puzzle

The European sovereign debt crisis of the past decade has rekindled a set of longstanding debates about the power of finance and the consequences of contemporary patterns in international crisis management for social justice and democracy. This book aims to make a contribution to these debates by revisiting a seemingly simple question whose answer has nonetheless eluded economists for decades: why do so many heavily indebted countries continue to service their external debts even in times of acute fiscal distress? While we generally take it for granted that borrowing governments will honor their foreign obligations under all circumstances, historical experience belies the notion that this is somehow a natural condition. Indeed, in the prewar and interwar periods, sovereign default was widespread and generally considered unavoidable in major crises. During the Great Depression of the 1930s, virtually all European and Latin American borrowers suspended payments on their external debts. Today, by contrast, the declaration of such unilateral moratoriums is exceedingly rare: even as the crisis in the Eurozone reached a dramatic climax between 2010 and 2015, the total share of world public debt in a state of default fell to a historic low of 0.2 percent.¹ How do we account for this extraordinary degree of debtor compliance in the wake of the Great Recession?

The question itself is by no means new. In fact, economists have long recognized a fundamental paradox at the heart of international lending. Since the payment of interest on foreign debt effectively constitutes a wealth transfer from the borrower to its lenders, a distressed debtor that spends more of its tax revenues on external debt servicing than it attracts in new loans has an inherent incentive to suspend payments. In the absence of a world government or imperialist power capable of dispatching gunboats to enforce compliance with cross-border debt contracts, we would therefore expect sovereign default to be a much more widespread phenomenon than it really is. Indeed, if we were to draw the assumptions of neoclassical economics to their logical conclusion, a self-interested government should try to pile up as many foreign obligations as possible before repudiating them in total. As rational lenders would in turn refuse to extend further credit to opportunistic borrowers, the result would be a collapse of global capital markets—meaning there should be no such thing as external debt to begin with.² Yet this is clearly not what happens. Despite the

frequency and intensity of international financial crises in recent decades, the total amount of outstanding sovereign debt has actually skyrocketed to a record \$60 trillion, or over 80 percent of global GDP (see figures 0.1 and 0.2). Although this increase has been more pronounced in some regions than in others, with many developing countries even reducing their debt-to-GDP ratios over the past two decades, the global upward trend still raises the question how national governments are able to sustain such enormous sovereign debt loads, and why they willingly continue to honor their foreign obligations in times of crisis.

The puzzle of sovereign debt repayment is further compounded if we consider its far-reaching redistributive implications. As a result of the rapid expansion of global finance and the widespread insistence on full repayment, recent decades have witnessed a vast and largely uninterrupted flow of capital “upstream”: from public hands in the global periphery to private hands in the advanced capitalist core. In the years since 1982, developing countries have thus ended up transferring an estimated \$4.2 trillion in interest payments to their creditors in Europe and North America, far outstripping the official-sector development aid these countries received during the same period.³ Meanwhile, in an anxious bid to reassure investors that their growing debt loads will be honored in full, European governments have spent the greater part of the past decade pursuing deeply unpopular austerity measures and forcing distressed peripheral borrowers—most notably Greece—to push through painful structural adjustment programs reminiscent of those that had previously been imposed on the Global South. In both cases, the aggressive pursuit of austerity led to mounting social discontent and intensifying political instability. In light of the recent tumult in global financial markets and the antiestablishment revolts rocking the liberal world order, it would therefore not be an exaggeration to claim that the problem of sovereign debt repayment has become one of the defining and most contentious political issues of our time. Given this context, why do heavily indebted countries not simply suspend payments on their external debts more often? What moves them to assume the full burden of adjustment for recurring international crises, inflicting enormous damage on their own economies and untold suffering on their people, while letting their creditors off scot-free? Why not default?⁴

In this book, I aim to answer these questions through a wide-ranging comparative-historical investigation of the political economy of sovereign debt and international crisis management: from the rise of public borrowing in early-modern Europe through the era of high imperialism and the gunboat diplomacy of the late nineteenth century, on to the wave of sovereign defaults that caused international capital markets to collapse during the Great Depression, right up to the developing-country debt crises of the neoliberal era and the recent turmoil inside the Eurozone—culminating in the dramatic defeat of Syriza’s short-lived antiausterity experiment in 2015. Delving into the *longue durée* of international government finance, and building on in-depth case stud-

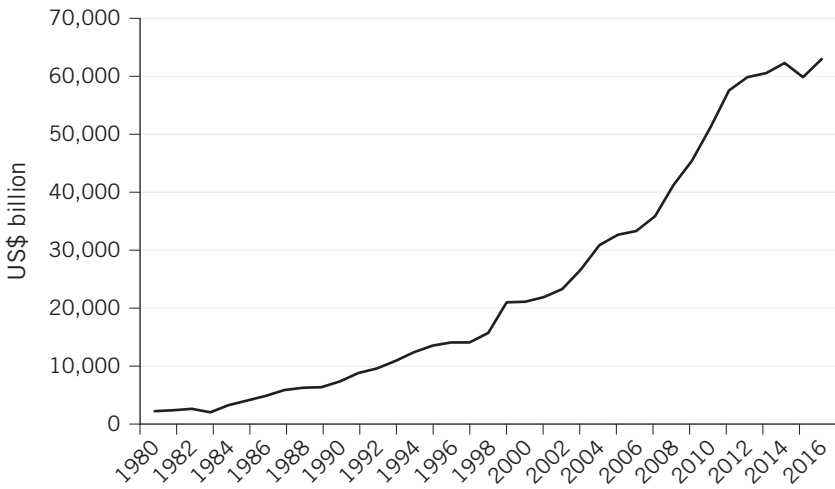


FIGURE 0.1. Gross world public debt, 1980–2016. *Source:* Bank of Canada (2017).

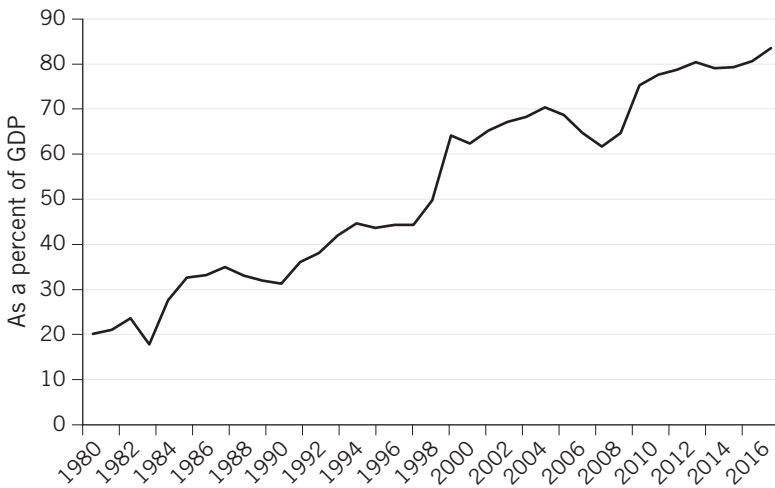


FIGURE 0.2. Gross world public debt/GDP ratio, 1980–2016. *Source:* Bank of Canada (2017).

ies of three of the most substantively important and theoretically interesting sovereign debt crises of the contemporary period (Mexico's lost decade of the 1980s, Argentina's record default of 2001, and the ongoing debt crisis in Greece), I aim to shed fresh light on the recent transformations of global capitalism and the often invisible enforcement mechanisms of debtor compliance

that lie embedded deep within the global financial architecture. In the process, I hope to explain not only why heavily indebted countries generally honor their financial obligations, but also why they sometimes choose to defy their foreign lenders and default on their debts anyway.

My focus on the “hard times” of fiscal distress is deliberate. By noticeably intensifying distributional conflict over scarce public resources, sovereign debt crises tend to lay bare underlying power dynamics that, during normal times, are quietly at work beneath the surface. Identifying the exact nature of these power dynamics will allow us not only to find new answers to the intractable theoretical puzzle at the heart of this book, but also to engage with a number of long-standing debates in the social and political sciences on the fraught relationship between capitalism and democracy under conditions of globalization and financialization. As I will argue in the chapters that follow, it is the vast increase in the structural power of finance over the past four decades—revolving around the capacity of private and official lenders to withhold the short-term credit lines on which all states, firms, and households depend for their reproduction—that has driven the generalized trend away from unilateral default. Before I can further elaborate on the complex nature of these dynamics, however, we have to first dispense with a persistent misunderstanding that has long clouded our thinking about global finance and about sovereign lending in particular: the idea that all government debt is an essentially “risk-free” investment, and that heavily indebted countries always will (and always should) repay their foreign debts in full—or, as former Citibank chairman Walter Wriston infamously put it on the eve of the Latin American debt crisis of the 1980s, the notion that “countries don’t go bust.”

While Wriston’s words may ring true in the context of the Eurozone today, where even Greece’s nominally left-wing government has insisted on repaying an essentially unpayable debt, it does not necessarily hold up once we place matters in a more long-term perspective. In fact, the historical record of government borrowing is littered with examples of nonpayment, and the option to pursue a unilateral suspension of payments long featured prominently in the policy toolkit available to heavily indebted countries during times of crisis. The key question, then, is why this option is no longer being seriously considered in our contemporary era of neoliberalism (1980–present).

A VERY BRIEF HISTORY OF SOVEREIGN DEFAULT

The starting point for this research project is the observation that things were not always the way they are today. Medieval kings and early-modern rulers regularly defaulted on their obligations to foreign bankers, as happened perhaps most famously in the case of Edward III of England, whose repudiation of a major war loan from the mighty Bardi and Peruzzi banks of Florence allegedly

contributed to that city's banking crisis of the 1340s. Similarly, the serial defaults of Philip II of Spain are said to have nearly felled the illustrious Fugger and Welser banks of Augsburg, while investors on the Amsterdam capital market suffered the crippling consequences of mass sovereign default during and after the Napoleonic Wars. With the internationalization of finance under British hegemony in the nineteenth century, the suspension of payments by distressed peripheral borrowers became even more common, to a point where unilateral debt moratoriums came to be considered "normal and part of the rules of the game" during times of crisis.⁵ As Max Winkler, one of the world's first sovereign debt scholars, wrote by the early 1930s, "fiscal history . . . is replete with instances of governmental defaults. Borrowing and default follow each other with almost perfect regularity. When payment is resumed, the past is easily forgotten and a new borrowing orgy ensues."⁶ Figure 0.3 confirms this observation, showing how each of the three major international lending booms prior to World War II ended in a wave of sovereign defaults. The international debt crises of the 1820s, 1870s, and 1930s each stand out in sharp relief.

Take the first lending cycle of the 1820s, in which the independence struggles of a number of Latin American and Mediterranean countries coincided with a speculative craze on the London Stock Exchange. In the space of just three years, between 1822 and 1825, dozens of newly emerging states contracted multiyear loans on international capital markets to finance their costly independence wars. For the borrowers, the lending spree was a boon: it enabled them to raise armies, fight off their colonial masters, and establish themselves as sovereign nations in their own right. For investors, however, the experience ended in tears as virtually all these new states almost immediately suspended payments in the bust that followed. Peru was first to default, in April 1826, followed by Colombia. By 1829 all Latin American and southern European borrowers—with the exception of Brazil and the Kingdom of Naples—were in arrears, and there was remarkably little bondholders could do to recoup their investments.⁷ The defaulting states mostly did not resume payments until after their economies had recovered, foreign-exchange reserves had been replenished, and the defaulted debt had been restructured on terms that were generally considered to be favorable to the borrowers. As a leading historian of the episode wrote, "during a quarter of a century most of [these new borrowers] maintained an effective moratorium on their external debts, which indicated an appreciable degree of economic autonomy from the great powers of the day."⁸

In the late 1860s and early 1870s, European capital began to flow back towards Latin America and the Mediterranean, but the expansion of international lending again turned out to be short-lived, with most borrowers suspending payments following the crisis of 1873. As in the previous wave, the defaults of the Long Depression (1873–1896) were unilateral and outright. An intermittent lending boom in the 1880s, centering mostly on foreign direct investments in railways, agriculture, and mining, culminated in the near-collapse of the

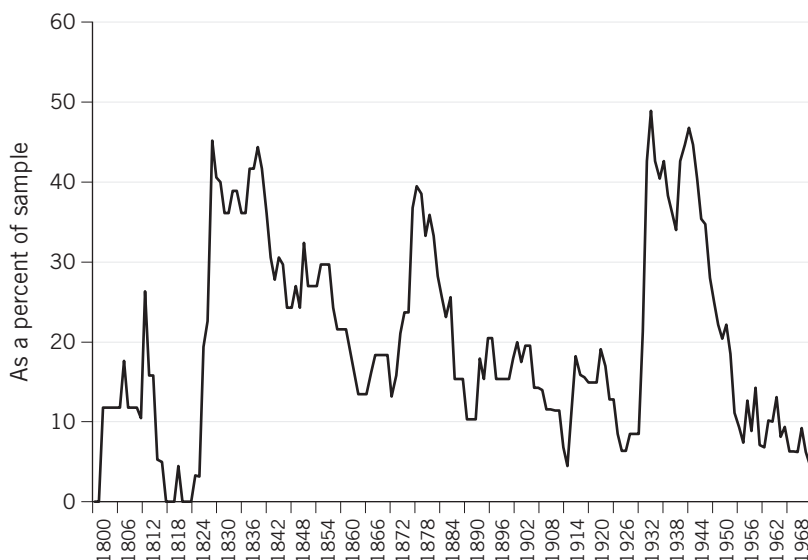


FIGURE 0.3. Share of countries in a state of default, 1800–1971. *Source:* Reinhart and Rogoff (2009).

Note: The data for this graph is based on a sample of 66 countries and does not include the defaults on U.S. war credits after World War I. The time series has been capped at 1971 (the year of the Nixon shock, which marked the collapse of the Bretton Woods regime) to indicate the prewar pattern in sovereign default and its steady decline in the immediate postwar years, when there was no significant cross-border lending. Reinhart and Rogoff’s data series includes another major spike in the share of defaults in the 1980s, but as we will discuss in greater detail in the theoretical discussion in chapter 2 and in the Mexican case study, the defaults of the 1980s were qualitatively different from the prewar defaults, in that they merely involved a multilateral rescheduling of principal amortization (followed much later by the Brady deal) as opposed to the unilateral payment suspensions that characterized the default waves of the 1820s, 1870s, and 1930s.

mighty Barings Bank of London when a financial panic surrounding bad loans on several projects along the River Plate ended in the Argentine default of 1890. It was in this period—the classical gold standard era of 1870–1913—that the dominant creditor states began to assert themselves much more aggressively to defend bondholder interests and enforce cross-border debt contracts. With the rise of finance capital and growing intercapitalist rivalries feeding the expansionist ambitions of the European powers and the United States, the threat and use of force became an increasingly frequent fixture in the settlement of foreign debt disputes—a development that was famously analyzed and criticized by the classical theorists of imperialism.⁹

While scholars still disagree on how widespread military intervention really was in this period, one study has found that noncompliant borrowers risked a

30 percent chance of being subjected to foreign invasion, gunboat diplomacy, or the establishment of international financial control.¹⁰ Often-cited examples include the imposition of European control over public finances in Egypt, the Ottoman Empire, and Greece; the naval blockade and shelling of Venezuelan harbors and coastal defenses; and the occupation of the customs houses of several Caribbean and Central American states by U.S. marines. On the whole, however, it was generally the more subtle and indirect influence of *haute finance* itself—operating through the disciplinary mechanisms of the bond market, the structural constraints imposed by the international gold standard, and the monopoly power of major underwriting banks like the House of Rothschild—that enforced compliance. As Karl Polanyi poetically put it in *The Great Transformation*, “the Pax Britannica held its sway sometimes by the ominous poise of a heavy ship’s cannon, but more frequently it prevailed by the timely pull of a thread in the international monetary network.”¹¹

After World War I brought the Pax Britannica and the hour of high finance to a violent end, the Roaring Twenties that followed gave rise to yet another major bout of speculative investment. As before, this third sovereign lending cycle quickly turned to widespread default in the international debt crisis of the 1930s. This time, however, the resort to military intervention had been all but ruled out in foreign debt disputes, leaving bondholders once again powerless in the face of a wave of unilateral payment suspensions. With the exception of Argentina and some of the smaller debtors, all Latin American countries suspended payments, as did the majority of European states. In his classic study of government insolvency, Winkler concluded that “defaults are inevitable when attempts are made by lenders to take advantage of temporarily embarrassed borrowers by exacting all sorts of concessions and imposing all sorts of impossibly harsh terms.”¹² The lessons from history are therefore relatively unambiguous: not only was default common to the point of being considered “normal” or even “inevitable” in times of crisis, but in suspending payments the heavily indebted states of the prewar period also displayed a remarkable degree of economic autonomy, allowing them to shift at least part of the burden of adjustment onto foreign bondholders. While this certainly does not mean that the prewar period was more socially progressive than the contemporary period—in fact, it is widely understood that disenfranchised workers suffered the brunt of the adjustment costs during repeated crises under the classical gold standard—past research does seem to indicate that defaulting countries experienced faster recoveries than nondefaulters, while their debts were generally restructured on more favorable terms.¹³

Clearly, this historical experience contrasts sharply to the management of sovereign debt crises in the contemporary period. Even in the absence of a military enforcement regime, the repayment record of distressed borrowers appears to be better today than it has been at any other point in history following a major international crisis. By the early 1980s, a new rule seemed to have

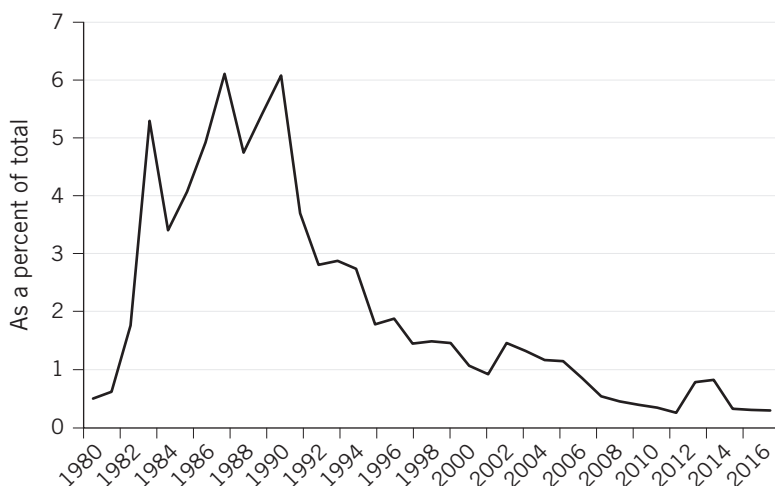


FIGURE 0.4. Share of world public debt in default, 1980–2016. *Source:* Bank of Canada (2017).

emerged: governments must repay their external debts and avoid a unilateral suspension of payments at all costs.¹⁴ Of course, this is not to say that the problems of government insolvency or the risk of nonpayment have been eradicated altogether—in fact, given the rapidly rising public debt levels in some parts of the world, it is by no means inconceivable that we will witness further default waves in the future, with commodity exporters like Venezuela and some of the so-called frontier markets in sub-Saharan Africa possibly being first in line. But insofar as sovereign defaults still occur today, they generally take the form of orderly settlements undertaken at the initiative of private creditors, rather than the more confrontational unilateral payment suspensions that characterized the first three waves of default in the prewar and interwar periods. This observation is particularly puzzling if we consider the fact that the decades since the collapse of the Bretton Woods regime have been by far the most tumultuous in economic history, with financial crises twice as frequent after 1971 as they were during the first era of globalization before 1914.¹⁵ Still, despite the intensification of market turmoil in recent years, the incidence of unilateral sovereign default today is remarkably low. While there was a brief uptick in negotiated debt restructurings in the 1980s, a point to which we will return later in the book, the phenomenon of sovereign default as such—in both its unilateral and negotiated forms—has been exceedingly rare since then. Even in the wake of the global financial crisis of 2008, during the worst economic downturn since the 1930s, the total share of world public debt in a state of default consistently remained well below 1 percent (see figure 0.4).¹⁶

The fact that sovereign borrowers usually repay their external debts, and that global capital markets have actually been thriving in spite of the frequency and intensity of sovereign debt crises in recent decades, is a clear indication of the fact that investors generally expect governments to honor their international obligations—even if they cannot. But how can these investors be so sure? Why are private creditors so confident that foreign governments will dutifully uphold their external debt service under all circumstances? That is the main question this book seeks to address.

WHY DO GOVERNMENTS REPAY THEIR DEBTS?

The first to identify the so-called enforcement problem of cross-border debt contracts were economists Jonathan Eaton and Mark Gersovitz, who, in a seminal paper published in 1981, argued that policymakers ultimately repay their country's external debts because they are concerned about the government's future access to credit and want to safeguard their country's reputation as a "good borrower."¹⁷ This reputational explanation caught on, but it was not without its critics. Soon a new body of literature emerged seeking to disprove the reputation hypothesis on theoretical and empirical grounds, with a different group of scholars proposing the role of sanctions, like lawsuits and trade embargoes, in enforcing compliance.¹⁸ Others still proposed that the institutions of liberal democracy—especially a strong parliament, independent judiciary, and powerful central bank—compel the executive to respect creditor rights and credibly commit to its obligations.¹⁹ Yet while economists have since published a raft of books and articles purporting to resolve the intractable paradox at the heart of the sovereign debt puzzle, they have failed so far to reach a conclusive answer on the matter. As three prominent scholars in the field noted on the eve of the European debt crisis:

Almost three decades after Eaton and Gersovitz's path-breaking contribution, there is still no fully satisfactory answer to how sovereign debt can exist in the first place. None of the default punishments that the classic theory of sovereign debt has focused on appears to enjoy much empirical backing. . . . In sum, thirty years of literature on sovereign debt do not seem to have resolved some of the fundamental questions that motivated the field.²⁰

In this book, I therefore propose to approach the problem from a somewhat different angle. Instead of looking at sovereign debt repayment as a purely *economic* question, I propose to build on the insights developed by a previous wave of political-economy scholarship—especially on the Latin American crisis of the 1980s—that highlighted the thoroughly *social* and *political* nature of these questions.²¹ First of all, sovereign debt repayment is a *social* question insofar as the decision to honor or not to honor a foreign obligation has important

redistributive implications—both between the debtor and the creditor, and within the debtor country itself. At the same time, it is also crucially a *political* question insofar as these distributional conflicts in turn feed into protracted power struggles between different social groups over who is to shoulder the burden of adjustment for the crisis.²²

The basic questions thus become: who pays, and why? One of the main reasons why the traditional explanations of debtor compliance in the economics literature have had difficulties accounting for prevalent policy outcomes, I will argue, is precisely because much of this past work has tended to *depoliticize* the subject matter. In the real world, the decision to respect an international debt contract cannot be isolated from questions about who gets to call the shots and who gets to bear the burden of adjustment in the management of international debt crises or the repayment of sovereign debt more generally. Every time a government chooses to repay rather than suspend or repudiate its foreign obligations, it finds itself making a social and political as much as an economic calculation, and it does so within a context of domestic demands and international pressures that may structurally constrain the government's room for maneuver and systematically incentivize one set of policy choices over another. Understanding the role of such external constraints and internal motivations in enforcing compliance is therefore foundational to the effort of developing an adequate theory of sovereign debt and default. With this in mind, the theoretical discussion in Part I of this book will assess some of the shortcomings of past scholarly contributions in this area and propose the basic contours of a critical political economy approach that foregrounds the proliferation of distributional conflicts and political struggles in times of crisis.

As noted before, the central argument I aim to develop in these pages is that recent transformations in the global political economy have endowed private and official lenders with a peculiar form of power over their sovereign borrowers: what I will call *structural power*. In chapter 3, I review the extensive literature on this concept, before setting out to demonstrate how the structural power of finance ultimately revolves around a fairly straightforward capacity, namely the capacity to withhold the short-term credit lines on which all economic actors in the borrowing countries—states, firms, and households alike—depend for their reproduction. In a context of growing credit dependence, private and official lenders can inflict debilitating “spillover costs” onto a defaulting country simply by refusing to provide further loans, thereby unleashing a host of crippling knock-on effects that would threaten to undermine social harmony and the political legitimacy of the borrowing government. Crucially, these spillover costs have been greatly amplified as a result of the restructuring of the capitalist world economy since the 1970s, leading to a situation in which a unilateral suspension of payments has become all but inconceivable in most situations. As globalization and financialization have firmly entrenched the centrality of finance in the process of capital accumulation, the governments of territorially delimited

BOX 0.1. THE THREE ENFORCEMENT MECHANISMS OF DEBTOR COMPLIANCE

1. The **market discipline** imposed by an **international creditors' cartel**, which can inflict debilitating spillover costs by withholding further credit in the event of noncompliance;
2. The **conditional loans** provided by the **international lender(s) of last resort**, which aim to keep the debtor solvent while simultaneously freeing up resources for foreign debt servicing, and which can also inflict debilitating spillover costs by withholding further credit;
3. The **bridging role** of fiscally orthodox **domestic elites**, whose hand is strengthened by their capacity to attract foreign credit at better terms than their more heterodox and democratically responsive counterparts, serving to internalize discipline into the debtor's state apparatus.

nation-states have grown increasingly subservient to international creditors for their own survival. This has in turn caused the international balance of power to shift decisively in favor of private financial interests, international financial institutions, and the dominant creditor states, while shifting the domestic balance of power decisively in favor of big firms and financial elites whose interests in repayment are broadly aligned with those of foreign creditors.

The idea that private firms enjoy a position of structural power in advanced capitalist democracies has a long-standing pedigree in the sociology and political science literature, going back to some of the foundational debates on business power and the capitalist state of the 1960s and 1970s.²³ After briefly falling out of vogue over the course of the subsequent decades—partly due to a broader shift in scholarly priorities, but also due to what was widely considered to be its rather unwieldy and deterministic original formulation—the structural power hypothesis has recently experienced somewhat of a revival in the comparative and international political economy scholarship on the global financial crisis.²⁴ This book aims to make a contribution to this (re-)emerging body of literature by developing a dynamic theory of the structural power of finance in sovereign debt crises that can account for debtor resistance and variation in social and political outcomes. My main objective in this respect is to uncover the *exact mechanisms* through which the power of private and official creditors operates in practice, and the *precise conditions* under which this power is effective and under which it breaks down. The argument outlined in the following chapters fundamentally revolves around what I will call *the three enforcement mechanisms of debtor compliance*, which are briefly summarized in box 0.1. Each of these mechanisms involves the capacity of a different group of lenders and intermediaries—foreign private creditors, foreign official creditors, and domestic elites, respectively—to withhold the short-term credit lines on

which heavily indebted states depend for their reproduction, thereby inflicting debilitating spillover costs onto the borrowing country's wider economy, with unpredictable but far-reaching social and political consequences.

In the historical discussion and case studies presented in this book, I will trace the evolution of these three enforcement mechanisms over time and will show how their effectiveness has greatly increased in recent decades—even if it continues to vary from case to case, depending on the specific conditions prevailing in a given political-economic context. Moreover, I identify three specific developments of the neoliberal era that have significantly strengthened each of these mechanisms, namely (1) the growing concentration and centralization of international credit markets; (2) the effective integration of official-sector intervention and the IMF's lender-of-last-resort function into the global financial architecture; and (3) the growing dependence of the capitalist state—and the capitalist economy more generally—on private credit, which has tended to strengthen the position of financial elites in creditor and debtor countries alike. Taken together, these developments have conspired to gradually disempower those in favor of a more confrontational policy response and a more equitable distribution of adjustment costs, rendering debtors increasingly reluctant to suspend payments and contributing to a *generalized trend* away from unilateral default.

THE THREE ENFORCEMENT MECHANISMS OF DEBTOR COMPLIANCE

To contextualize this argument about the structural power of finance in sovereign debt crises, we will first need to take a closer look at the structural background against which the three enforcement mechanisms of debtor compliance have evolved since the collapse of the Bretton Woods regime in the 1970s. In chapters 3 and 4, I will argue that the growing power of creditors is a direct consequence of the three interrelated processes outlined above. The first—the vast increase in the concentration and centralization of international credit markets—has led to a situation in which the liabilities of peripheral borrowers are now increasingly held by an ever-smaller circle of systemically important and politically powerful private banks and financial institutions in the advanced capitalist countries. As we will see in the contemporary case studies, it has made little difference whether sovereign lending took the form of bond finance or the form of bank loans: the point, I will argue, is that the international credit system as a whole—including the market for government bonds—has become much more concentrated and much more centralized in recent decades. Moreover, owing to the growing interdependence and increased fragility of the international financial system as a result of globalization, big banks and institutional investors tend to share a collective interest in repayment, making it easier for them to act as one and present a unified front against their sovereign

borrowers in times of crisis. As we will see in the historical discussion, this situation contrasts sharply to the highly decentralized bond finance of the 1920s and 1930s, in which small and atomized retail investors were much more dispersed and found it much more difficult to maintain a unified creditor front, coordinate creditor action, and exert the requisite leverage over noncompliant borrowers.

Today, the highly concentrated and centralized structure of international lending has allowed private banks and institutional investors in the rich countries to successfully prevent opportunistic behavior by individual lenders, enabling them to form a relatively coherent international creditors' cartel capable of threatening an immediate withdrawal of further credit in the event of non-compliance.²⁵ At the same time, the fact that fewer lenders are involved—and the fact that these lenders' interests are now structurally interlocked at the level of a highly integrated global financial system—also makes it easier for them to coordinate a collective roll-over of maturing debts and keep providing further short-term credit lines to maintain the borrower's solvency and ensure maximum debt repayment. I will argue that, by facilitating this precarious balancing act between continued financing and the credible threat of a wholesale credit withdrawal, the concentration and centralization of international credit markets has greatly strengthened the first enforcement mechanism of *market discipline*. As an important side-effect, it has also helped ease private creditor coordination in international debt negotiations.

The second important structural change of the neoliberal era concerns the effective integration of official-sector intervention—both by the dominant creditor states and by international financial institutions—into the global financial architecture. This development is a corollary of the first, in the sense that the growing concentration and centralization of international credit markets has contributed to a situation in which many of the leading financial firms are now considered “too big to fail” by investors and policymakers alike. In a word, the accumulation of foreign government debt on the balance sheets of an ever-decreasing number of systemically important private financial institutions has meant that a disorderly default in the periphery now risks triggering a deep financial crisis in the creditor countries. As a result, a systemic need arises—from the perspective of global finance and the creditor states—for an international lender of last resort capable of “bailing out” distressed peripheral borrowers in order to prevent contagion towards the overexposed banks and institutional investors of the core countries. The provision of conditional emergency loans by creditor states, central banks, and international financial institutions thus presents an essential complement to the market mechanism, which, as we will see in the case studies, remains prone to failure in times of investor panic. Just like market discipline, this second enforcement mechanism revolves around a simple act of refusal, namely the lenders' capacity to stop providing credit to a noncompliant borrower that depends on it. Given the short-term economic consequences of a complete

cutoff of foreign financing, the mere threat by official creditors to withhold future loan installments is generally enough to ensure compliance.

Over the past decades, different official-sector creditors have fulfilled the role of an international crisis manager or lender of last resort. The U.S. Federal Reserve and U.S. Treasury Department actively intervened in the developing country debt crises of the 1980s and 1990s, while the European Central Bank and EU creditor states—led by Germany and France—did the same during the more recent European sovereign debt crisis. In all cases, official-sector creditors disbursed sizable “bailout” loans that were made conditional on far-reaching budget cuts, tax hikes, privatizations, and market reforms aimed at maximizing foreign exchange earnings and freeing up public revenue for external debt servicing. From the early 1980s onwards, private lenders and creditor states have increasingly come to rely on the intervention of the International Monetary Fund, which, in addition to its conditional lending, has effectively assumed the role of a fiscal disciplinarian for distressed sovereign borrowers, monitoring their compliance with loan conditions to ensure full and timely repayment. Moreover, the stamp of approval provided by the IMF following the successful conclusion of a Stand-By Arrangement signals to private investors that a distressed debtor is pursuing “sound” policies and is committed to repaying its debts. Beside keeping the debtors solvent, the result of this growing reliance on IMF intervention has therefore been to endow the Fund with a gate-keeping function over market access that in turn helps the private creditors’ cartel remain relatively unified as well. All in all, the IMF’s growing centrality in international crisis management has ended up institutionalizing a set of financial surveillance, monitoring, and control functions that had hitherto been only partially, irregularly, and improvisationally fulfilled by private banks and creditor states themselves. In the process, it has served to entrench the second enforcement mechanism of *conditional lending*.

The third key change involves the thorough restructuring over the same period of state-finance relations and the domestic political economy of the borrowing countries themselves—a transformation that has been characterized by rising public debt levels and growing state dependence on private credit.²⁶ Ever since the 1980s, these developments have conspired with increased capital mobility and the far-reaching deregulation of financial markets to greatly intensify the competitive pressures on national governments, which now find themselves compelled to constantly reproduce the ideal conditions for foreign lending and private investment. Taken together, these developments have ended up strengthening the political position of those social groups whose material interests and ideological convictions are broadly aligned with those of foreign creditors, at the expense of those whose loyalties continue to lie with working people back home. Wealthy domestic elites and fiscally orthodox, business-friendly technocrats in particular tend to inspire the confidence of foreign creditors due to their shared interest in—and credible commitment to—continued debt servic-

ing. This higher degree of “credibility” enables establishment forces inside the government and the financial bureaucracy to attract credit on better terms than their more democratically responsive counterparts, whose redistributive policy preferences tend to scare away investors. Over time, the result of this dynamic has been to internalize debtor discipline within the borrowing countries’ state apparatus through a dramatic reconfiguration of domestic power relations, thus cementing the third enforcement mechanism: the *bridging role* of domestic elites with close ties to the international financial establishment.

These three structural changes have in turn gone hand in hand with a profound normative shift that has seen the firm entrenchment of neoliberal ideas about crisis management and the reaffirmation of a culturally embedded creditor morality that places the responsibility for adjustment squarely on the shoulders of the debtor. As Nietzsche pointed out long ago, this creditor morality is powerfully expressed in the German word *Schuld*, which means both debt and guilt, so that deep down a distressed debtor is always already considered to be responsible for their own predicament.²⁷ This shift in prevalent norms about debt repayment is clearly reflected in the stark contrast between the prewar concern with preventing moral hazard and the contemporary concern with defending creditor rights. The Palmerston doctrine of 1848, one of the cornerstones of the regime of *laissez-faire* liberalism, still held that the British government reserved the right *not* to intervene on bondholders’ behalf in international debt disputes, so as to discourage “hazardous loans to foreign governments who may either be unable or unwilling to pay the stipulated interest thereupon.”²⁸ Later, during the Great Depression, Franklin D. Roosevelt’s good neighbor policy even propelled the U.S. president to personally apologize to his Latin American counterparts for Wall Street’s “super-salesmanship” in the lead-up to the crisis, acknowledging that “of course” the debtor countries were “unable to pay either the interest or the principal” on their obligations to U.S. bankers.²⁹ Today, by contrast, the idea that nonpayment could be considered a permissible policy response or that unpayable debts could actually be written off is clearly anathema: all debts contracted by a sovereign state must and will be repaid on the stipulated due date, unless private creditors voluntarily agree to reschedule or restructure them. Ever since the early 1980s, the widely shared expectation is therefore that—irrespective of the social, political, and economic costs of continued repayment—the borrower will bear the full burden of adjustment even as the lenders are made whole.

CONSEQUENCES FOR INTERNATIONAL CRISIS MANAGEMENT

Taken together, these structural changes and normative shifts in the global political economy have had far-reaching implications for the prevailing approach to international crisis management. By dramatically increasing the structural

power of finance and greatly raising the spillover costs of default as well as the uncertainty surrounding more confrontational courses of action, the inter-related processes of globalization and financialization have ended up imposing considerable constraints on the economic sovereignty, policy autonomy, and fiscal room for maneuver available to the governments of heavily indebted peripheral states—undermining both the actual and the perceived viability of more equitable and more democratically responsive alternatives to austerity and full debt repayment.³⁰ After all, if a distressed sovereign borrower were to defy its creditors and default on its external debts today, it would not only be forced into fiscal balance right away, as lenders would refuse to extend further credit or roll over outstanding obligations; it would also have to contend with devastating and largely unpredictable collateral damage to its domestic economy.

The spillover costs of default would initially spread through the transmission belt of the financial sector, with a default on foreign creditors likely to provoke capital flight, a stock market crash, and a collapse of domestic banks and pension funds. But given the centrality of finance to contemporary capitalism, the consequences would quickly ripple throughout the wider economy, risking massive social dislocation in the process. Exporters and importers would no longer be able to obtain trade credit, causing shortages of crucial consumables and industrial inputs; depositors would fear the safety and value of their savings and would likely instigate a bank run and mass capital flight, making the imposition of unpopular capital controls all but inevitable; producers would no longer be able to attract foreign or domestic investment and would start laying off workers in droves; households would see unemployment skyrocket while no longer being able to obtain credit for consumption, as a result of which aggregate demand would dry up—in sum, the bankruptcy of the state would risk provoking the bankruptcy of large parts of the domestic economy, with devastating social consequences (at least in the short term) and potentially grave implications for the government's capacity to legitimize itself in the eyes of its citizens. Given the ability of foreign lenders to inflict such debilitating spillover costs simply by withholding short-term credit lines, it is perhaps no surprise that many governments—including those of a leftist or even anticapitalist persuasion—are loath to defy their foreign lenders. Compliance becomes the rule.

As we will see in the contemporary case studies later in this book, the result of these dynamics has been to greatly reduce the room for maneuver available to the governments of heavily indebted countries. As the spillover costs of default have been amplified by the financialization of the world economy, the policy response to major international debt crises has therefore increasingly come to be imposed from abroad by global financial markets, international financial institutions, and the dominant creditor powers, with the active collusion of domestic elites inside the borrowing countries. This in turn has had far-reaching implications for the democratic responsiveness of debtor

country governments. Across the globe, parties of the left have begun to adopt the mantra of budgetary discipline and debt repayment that had long been the prerogative of the fiscally orthodox right. In the process, domestic party politics has effectively ceased to explain prevailing policy outcomes, rendering national elections increasingly meaningless. Germany's finance minister, Wolfgang Schäuble, infamously summarized the new status quo ahead of the 2012 parliamentary elections in Greece, when he noted that the Greeks "can vote however they want, but whatever election result we have will change nothing about the actual situation in the country."³¹ While Schäuble's assessment may have been profoundly disturbing, he was not wrong. As political economists Klaus Armingeon and Lucio Baccaro observed early on in the Eurozone crisis:

Governments of different political orientations, of different political strength, with different capacities for concertation with the social partners found themselves implementing essentially the same structural adjustment program centered on public sector cuts, pension reform, easing of employment protection legislation, weakening of unemployment insurance, and flexibilization of collective bargaining rules. The only type of choice left to governments was in the modalities used to mobilize popular consensus for, or at least blunt hostility against, austerity.³²

Nevertheless, despite this generalized turn towards debtor compliance in recent years, it remains crucial to recognize that the power of finance is by no means absolute. Indeed, one of the key contributions of this book lies precisely in the attempt to explain why this power continues to vary from case to case, and why some distressed sovereign borrowers—most notably Argentina in 2001—still occasionally choose to defy their foreign lenders and suspend payments on their external debts. In the past, however, scholars working on the concept of structural power have often struggled to specify when this particular form of power is fully operative and when it is not, leading to a relatively deterministic account of political outcomes. In the theoretical section of this book, I will propose a two-pronged way out of this conundrum: first, by identifying the precise mechanisms through which the structural power of finance operates in practice, as well as the conditions and countervailing mechanisms under which these mechanisms are likely to fail or break down; and second, by taking social struggles seriously and allowing for the structural power of finance to be contested from below.

In subsequent chapters, I will show that—given the relatively open-ended nature of the distributional conflicts at the heart of international crisis management—borrowing governments never simply respond to external economic shocks in a coherent and completely predictable fashion. Different groups inside a country are likely to be affected differently by different policies, and some will stand to gain more from repayment than others. Moreover, since the spill-over costs of default tend to be relatively short-lived, generally lasting no more than one or two years, those who expect to be negatively affected by austerity

in the long run may come to favor a suspension of payments as a way out of their protracted immiserization. One common aspect of sovereign debt crises is therefore for social struggles to proliferate across the board, occasionally leading to intense popular contestation and demands for greater democratic representation that may undermine the perceived legitimacy of the borrowing government and destabilize the existing political equilibrium.

If those forces opposed to austerity and repayment manage to gain the upper hand in such struggles, or if they begin to threaten the political and economic privileges of the wealthy and powerful, the borrowing government may yet decide to pursue a more confrontational course of action, switching its policy preferences from compliance to default with an eye to alleviating domestic tensions by deflecting part of the burden of adjustment onto foreign lenders. Considering the instantaneous and destabilizing spillover costs of a credit cutoff, however, there is unlikely to be any meaningful confrontation with international creditors without a deep legitimation crisis and intense social mobilization leading to the rise to power of a prodefault coalition, or at least forcing the existing political and financial establishment to make far-reaching concessions to the domestic population in an attempt to restore the status quo and preserve its remaining privileges.

The Greek experience since 2010 has provided us with arguably one of the clearest contemporary manifestations of this fundamentally contested nature of international crisis management. The events surrounding the country's antiausterity referendum in 2015 plainly revealed how distributional conflict and asymmetries in the international and domestic balance of power are both key factors in sovereign debt repayment. Yet the conventional economic approaches to the study of international government finance have generally dismissed such factors as irrelevant in their analytical frameworks, or have bypassed them as immeasurable in their formal mathematical models. In light of recent developments, it has become clear that future scholarship on sovereign debt—and on global finance more generally—can no longer bypass its social and political dimensions. The contentious politics of austerity and the rise of powerful antiestablishment forces across the globe unequivocally demonstrate that foreign debt servicing has important redistributive implications that economists and policymakers ignore at their peril. A critical investigation of the political economy of sovereign debt and default—one that looks specifically at the structural power of finance in shaping political outcomes to its advantage—is therefore in order. This book aims to provide just that.