

BOOK REVIEWS

The Age of Debt Bubbles: Why and How to End It

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The Age of Debt Bubbles: An Analysis of Debt Crises, Asset Bubbles, and Monetary Policy

edited by Max Rangeley

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The Age of Debt Bubbles: An Analysis of Debt Crises, Asset Bubbles, and Monetary Policy, published by Springer in 2024, is a new book edited by Max Rangeley, who also coauthored three chapters. It deals with a very important and highly relevant topic: the authors present and reassess the available “crisis theories”; use them to diagnose recurring, monetarily driven crises; and, based on this, draw conclusions and propose solutions. Economic theory provides a robust theoretical framework that can explain why monetarily driven economic and financial crises occur repeatedly, why debt—especially government debt—keeps rising, why inflationary surges are frequent, and why asset bubbles form and burst, causing large-scale economic damage. At the same time, however, the authors point out that so far there seems to have been an unbridgeable gap between these theoretical insights and practical consequences as far as policy making is concerned. The chapters in this book are meant to make a much-needed contribution to close this gap.

Another thing that makes this book special is that some of the authors were once high-ranking representatives of the “fiat money regime” which they now review critically in their respective analyses. For instance, William White is the former chief economist of the Bank for International Settlements, Miguel Fernandez Ordoñez was governor of the (central) Bank of Spain, and Barbara Kolm served as vice president of the general council of the Austrian National Bank.

The book is divided into two parts. The first part, titled “Understanding the Monetary System and Debt Bubbles in Modern Economies,” focuses on theory, while the second part, titled “Policy Makers and the Age of

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Debt Bubbles,” addresses practical monetary and fiscal policy matters. What follows will provide a brief overview of the individual chapters and conclude with some observations and a proposal for improving our monetary system.

Max Rangeley and William White explain in their introductory chapter, “How Money Is Created in a Modern Economy,” how and under what conditions money is created in modern economies, clearing up common misunderstandings. The authors point out that today’s fiat money regime, central bank money, and commercial bank money are essentially created out of thin air through lending. They explain the nature of different monetary aggregates and address the regulatory conditions—such as capital ratios, liquidity ratios, and reserves—under which commercial banks engage in credit and money creation. Central bank operations such as open market operations, quantitative easing, and other measures aimed at providing central bank money and setting interest rates are also described. The authors then go on to show how and why the credit and money creation by banks leads to boom-bust cycles. Additionally, they examine the so-called shadow banking system. Rangeley and White point out that while shadow banks do not create money in the same way commercial banks do when lending, they can increase the velocity of money through their lending activities. These institutions also help increase the credit and money creation capacity of commercial banks by offloading credit risks, which, in turn, eases capital constraints for banks: “The shadow banking sector, rather than creating M1 in the way that commercial banks do, may therefore act as an enzyme for the credit-creation activities within commercial banking and thereby facilitate more endogenous money creation than would have occurred otherwise” (22).

“Business Cycles, Debt Bubbles and the Monetary System” is the title of the second chapter, written by Rangeley, Roger Koppl, and Harry Richer. The authors first explain the importance of goods prices and interest rates in allocating scarce resources in an economy, pointing out the consequences when the state interferes with price structures and free interest rate formation. They then outline Austrian business cycle theory (ABCT), which is primarily based on the work of the Austrian school economists Ludwig von Mises (1881–1973) and Friedrich Hayek (1899–1992), explaining how money creation out of nothing causes economic distortions (overconsumption and malinvestment), initially manifesting as a boom but eventually followed by a correcting bust. The authors conclude with an assessment that a “super bubble” has formed, one whose bursting will surpass everything seen before: “We are likely in the biggest bubble in history and the bursting of it promises to be more painful by far than the Great Recession” (34). The chapter ends with appendices that explore various elements helpful in understanding ABCT in more detail, such as roundabout production, the price response of bonds to interest rate changes, the different ways the consumer goods and investment goods sectors respond to interest rate changes, and the effects of debt duration on the economy.

In their subsequent chapter, “Analysis of the Formation of the Super Bubble,” Rangeley, Koppl, and Richer deepen their analysis of the bubbles formed in recent decades, applying the theoretical insights introduced in their first chapter to the interpretation of economic data. With a series of compelling graphs, they illustrate and analyze the sequence of crises and crisis intervention policies. The empirical links between interest rate cuts by central banks and rising (inflating) stock prices, increasing debt, the quality of credit markets, the valuation of credit default risks, nominal assets relative to gross domestic product, housing price inflation, potential growth developments, and so forth are explored in quite some detail. Based on their analysis, the authors conclude that continuing as before—attempting to address the crises, which are primarily caused by monetary policy, with even looser money policies and more government debt and intervention—will ultimately weaken economic performance, impoverish large portions of the population, and leave the “patient,” metaphorically speaking, bleeding to death. The alternative, they argue, is a return to a free market system: “The right choice is clearly the second option. The right choice is to restore market prices, hard budget constraints, honest money, and economic liberalism. It is not the easy choice, but it is the only choice” (79).

The first chapter in part two of the book, titled “Why the Monetary Policy Framework in Advanced Countries Needs Fundamental Reform,” is written by William White, who argues that central banks, through their own monetary policies, have created the very bubbles that they later inflated even further. White sees the cause of these distortive policies in “false beliefs” on the part of central bank councillors that have led to “bad policy.” One such belief is the conviction among policy makers that monetary policy must be expansive, even during periods of a “positive global supply shock.” Additionally, he points out that the effectiveness of monetary policy is often overstated; expansive monetary policies can even be counterproductive to growth and employment. Furthermore, there are unintended consequences of easy money policies: income inequality rises, financial instability grows (especially in the banking sector), fiscal policy goes out of control, the independence of central banks erodes, economies’ potential growth trajectories may suffer, and emerging markets are adversely affected as loose monetary policies in developed economies lead to volatile capital flows in other parts of the world. White emphasizes that exiting from expansive monetary policy, once it has started, is difficult. For instance, when interest rates are raised after a long period of artificially low borrowing costs, the distortions that were hidden by the expansive monetary policy become visible. In light of this, White poses the question of how to improve the policy framework. If, as White argues, “false beliefs” lead to “bad policy,” it seems natural to replace these “false beliefs” with “true beliefs.” However, White reports that this idea has not been successfully implemented, as central bank committees have rejected it.

It is against this backdrop that White suggests strengthening structures that lead to greater stability: “Building in modularity (to isolate shocks), redundancy (to improve resilience), and negative feedback mechanisms are standard in engineering systems. So too is the desire to remove unnecessary complexity” (99). He advocates considering ideas proposed by the Chicago school in the 1930s, such as a 100 percent reserve requirements for banks. To this end, White favors measures for reducing money creation on the part of private banks, and strengthening (rather than weakening) the state’s role in the creation and distribution of money:¹ “By eliminating the capacity of private agents to create assets that can substitute for money created by the public sector, there could be a greater potential for controlling the upward drift in prices and for reducing the harmful ‘boom-bust’ cycles that have become increasingly common in recent years” (99). Finally, White recognizes the introduction of central bank digital currency (CBDC) as a means to move toward a “narrow money framework” as proposed by the Chicago school.²

Miguel Fernandez Ordoñez’s chapter, “Money, the State and the Market,” critically examines the growing state regulation of the banking system in the last decades, which contrasts sharply with the unregulated nature of the nonbank financial system. He writes: “The banking sector is the sector most intervened and protected by the State of all economic sectors in all countries of the world” (104). Fernandez Ordoñez then highlights the history of the banking system, noting that it gradually became a fiat money system due to state interventions and privileges (such as deposit insurance). What is more, the recurrence of crises, regularly met with protectionism and interventionism by the state, has eroded market forces further and further. Yet interventionism and protectionism are not identified as the root causes of the crises; instead, it is often claimed that “the market has failed.” Against this backdrop it is quite remarkable that Fernandez Ordoñez sees the issuance of CBDC as a first step toward liberalizing the payments and credit system—as under the status quo, he argues, the private sector determines the money supply, not the state or central bank. CBDCs represent the perfection of state control over the money supply. Fernandez Ordoñez suggests that through the issuance of CBDCs central banks could bring the money supply in line with money demand without disturbing market interest rates: because the supply of CBDC would be centrally controlled, commercial banks would lose their

1 If the state (or its central bank) is the only provider of money, the question is: How will the new money be created? If it is created through lending, then all the problems outlined by ABCT will result; this would not be much of a change vis-à-vis the current system. And if the central bank creates new money by the stroke of a pen, the question is: Who will get the new money, when, and how much of it? These questions may suffice to indicate how problematic it is to increase the role of the state in the money creation process.

2 In the interest of transparency, the author of this review would like to let readers know that he is rather critical of CBDC (to put it diplomatically). See, for instance, Polleit (2022).

ability to increase the money supply via lending (or to reduce it through loan repayments).³ Fernandez Ordoñez sees a positive effect on corporate financing, where more equity would be used.

In this context Fernandez Ordoñez notes that “CBDC is fiat money, which is a safe asset and which, by definition, does not vary in value” (108)—a rather problematic statement from an economic viewpoint, to say the least. What is more, he thinks that the introduction of CBDC would be a way to liberalize the whole monetary and financial market system: the state would set the CBDC money supply, and from then on, all existing privileges in the payment and credit sectors would be abolished. According to Fernandez Ordoñez, the result would be as follows: “We would find a system without a crisis in payment flows, full competition in payment and credit services, and a direct monetary policy without bubbles or slow recoveries, with interest rates that would no longer be manipulated by the State and would be the result of market forces” (108). Of course, such a reform would have to overcome strong vested interests, Fernandez Ordoñez writes. Unfortunately, he does not elaborate further on how exactly this could be achieved—and he ends his chapter with a quote from the communist dictator Mao Zedong, thus leaving perhaps a certain degree of discomfort among some readers.

In her chapter “Monetary and Fiscal Policy Challenges in Europe since 2000: A Comprehensive Analysis,” Barbara Kolm addresses the interaction between monetary and fiscal policy in the eurozone. She begins by outlining the institutional framework for both policy areas. The European Central Bank (ECB) controls the euro money supply and short-term interest rates in the eurozone, and its monetary policy is applied to all the nations participating in the euro area. Fiscal policy, on the other hand, is national, consisting of taxation, borrowing, and government spending. However, national fiscal autonomy is not absolute. In fact, it is subject to the provisions of the Stability and Growth Pact and the Fiscal Compact; and the Macroeconomic Imbalance Procedure is also in place to identify and address economic imbalances early on. Kolm highlights the importance and difficulties of the coordination problem between monetary and fiscal policy in the euro area—“The interplay between the two resembles a sort of intricate dance, where careful strategic choices and effective communication are essential to achieve optimal outcomes” (114)—which she examines by analyzing three critical phases that challenged the eurozone’s stability.

The first phase Kolm analyzes is the global financial and economic crisis of 2008–9, during which the ECB pursued a policy of massive expansion of the central bank’s money supply (“quantitative easing”). The ECB also directly supplied eurozone commercial banks with new ECB loans which had longer

³ In this context the pressing question arises, of course, of what the appropriate quantity of money in the economy is. How can central bank councillors know the answer to this question?

maturities (longer-term refinancing operations). Kolm briefly critiques this response based on the insights of ABCT. The second phase she examines is the Greek debt crisis of 2010; she outlines the origin and course of the crisis, particularly how the financial proposals for crisis resolution by the International Monetary Fund were influenced by the political considerations of European governments. The third crisis phase she addresses is fiscal policy in the wake of the politically mandated lockdowns related to COVID-19. To compensate for the resulting dramatic demand shortfall, euro area governments massively expanded deficits, financed primarily by money supply expansion on the part of the ECB. The result was (with a time lag) high inflation. Kolm concludes her chapter with some reflections on the problems arising from disappointed expectations regarding the reliability of institutions—discrepancies between goals and achievements—which she thinks are a particularly serious issue in the context of the European Monetary Union if the project is to have a future: “A decline in trust in institutions has downstream effects on European society” (124).

Syed Kamall’s chapter, “Politics and the Monetary and Banking System,” discusses how the global financial and economic crisis of 2008–9 triggered a wave of far-reaching state interventionism. Political circles quickly came to the conclusion that the market’s self-correcting forces should not be allowed to operate. As a result, governments extended the already strong regulation of the banking system even further. Kamall analyzes the period of cheap money from the perspective of Austrian economics and monetarism, and he also examines the recent inflationary wave in the UK as the result of swelling government deficits that were monetized by the Bank of England. Kamall particularly emphasizes that early warnings and criticisms coming from some economists about the inflationary consequences such policies would entail were ignored or rejected. Only later was it acknowledged (for instance, by the Economic Affairs Committee of the UK’s House of Lords) that neglecting the development of the money supply in monetary policy, for example, had been rather problematic; such acknowledgments effectively rehabilitated insights from Austrian economics and monetarism (133–34).

Kamall also looks forward and raises the question of what can be done. In this context he refers not only to “mainstream economic ideas”—like increasing central bank councillors’ accountability—but also to voices calling for ending central banking altogether (136). While acknowledging the many arguments that have been brought forward for upholding central banking, Kamall points out that demands for putting an end to the fiat money central banking system keep resurfacing. According to Kamall, one improvement within the prevailing monetary system might be a return to the gold standard, similar

to the Bretton Woods system.⁴ Alternatively, Kamall references Friedrich Hayek's idea of currency competition. From this perspective, he envisions a system in which different currencies—including cryptocurrency units—compete with each other, thereby increasing accountability for central banks and strengthening the sense of responsibility among central bank boards.

Anyone who reads the chapters in this book—which are all written in a way that is easy to understand even for nonexperts—cannot help but recognize that the root cause of many of today's economic and societal problems is the prevailing monetary system: a worldwide fiat money system in which money is literally created out of thin air through bank credit creation, and where extensive state regulation and state-granted privileges create additional distortions that harm the allocation function of markets. This convincingly explains the recurrence of economic and financial crises, inflationary waves, and chronically rising debt burdens, particularly in Western economies. The solution to these problems is self-explanatory, and some of the authors make it pretty clear. In its most logical and consistent form, the solution requires putting an end to the fiat money system and to the state's monopoly on money production—that is, denationalizing money, as proposed by Friedrich Hayek in 1976: creating a free market for money, where everyone would have the freedom to demand the money that suits their purposes best and, at the same time, where anyone would be free to offer goods that others may wish to use as money.

Anyone who recoils at the idea of radically changing the prevailing fiat money system might warm to the thought that currency competition, as Hayek proposed it, could provide the solution to the money problem. However, in this context it must be recognized that money supplied by the state (or its central bank) and currency competition do not go together. On the one hand, the state will do everything in its power to make life difficult for any money competitor, especially when alternative forms of money start to rise in popularity. On the other hand, there is strong reason to assume that currency competition will lead to “competitive exclusion”: the best money, from the perspective of money users, will push out of the market the less desirable money. In a truly free market for money, therefore, there is a tendency for a single, globally accepted money to emerge.⁵ So if one sees currency competition as the best system for achieving the best form of money, it is not enough to simply expose the state's monopoly on money to currency

⁴ It should be noted that the Bretton Woods system was a “gold-exchange standard” resting on the US dollar. That said, it was not a gold-standard, but a “pseudo-gold standard” at best.

⁵ For further explanations see, for instance, Polleit (2023, 123ff.) and Hoppe (1994, 50–51).

competition. One must effectively prevent the state and its central bank from issuing money, ensuring that they no longer intervene in the market for money.

Certainly, such a regime change might initially seem difficult to imagine for many people—as some authors in this book acknowledge. After all, what government would be willing to relinquish control over money production? However, the prospects for shaking off the fiat money system and ending central banking may not be as poor as they seem. The key to this change is, quite literally, the “enlightenment” of the general public (as conceived by the Prussian philosopher Immanuel Kant [1724–1804]): when people become educated about the real problems and very high costs the fiat money system causes, the path to comprehensive reform will most likely open up. Of course, such a reform would have to take place in a “bottom-up” rather than a “top-down” manner. For this reason, educational efforts must primarily target the general public, not the guild of government politicians and mainstream economists, whose main interest is typically the preservation of the system’s status quo, which secures their power or “expert” role. This book makes an immensely important contribution to this educational effort, going well beyond just highlighting the problems: reform ideas are presented, and the reader learns that there are ways out of the highly problematic fiat money regime.

It would, therefore, only be logical for Max Rangeley to continue his important work and address the proposals for a comprehensive reform of the monetary system in one of his next book projects. For the time being, however, I hope that this excellent book will gain widespread circulation—among experts as well as interested nonexperts—helping readers to better understand the problems of today’s monetary system and encouraging discussions on solutions that will lead to better money.

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