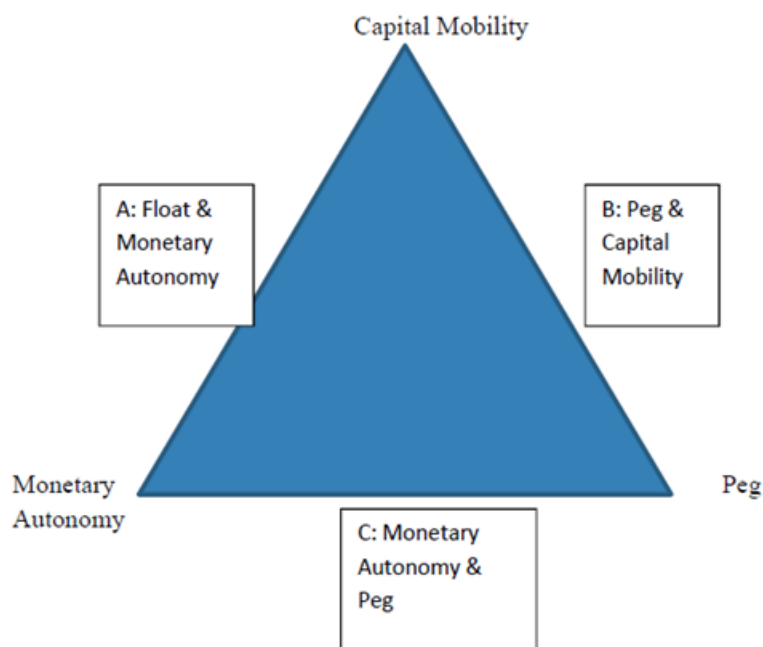


Comments On Block, "Redefining Socialism", by Menzie Chinn (mchinn@lafollette.wisc.edu)

May 1, 2015

My main comments will focus on technical aspects of the workings of the financial system.

International constraints (pages 11, 56: In the post-Bretton Woods era, the international monetary/financial system is better thought of as an international non-system. While neither the gold standard nor the post-War dollar standard now bind, all countries are subject to (at least) one set of constraints, sometimes called the impossible trinity, or the international trilemma.



So countries can choose two of the three options, but not all three simultaneously. Helene Rey has recently challenged this thesis, arguing that the dominance of finance means that there is only a dilemma, given that exchange rate regimes provide only minimal insulation against external forces.

An international financial tax would help in insulating economies from external shocks (and from the whims of the animal spirits in the financial markets).

Dodd-Frank (page 22): It seems too early to me to judge the recent implementation of reforms (still ongoing) as ineffective. In particular, given the operation of both Dodd-Frank and Basel III rules, the innovation of raising capital requirements (i.e., reducing leverage) is underway. The recent spin-off of GE's financial unit, for instance, could be seen as a recognition that the return to equity from highly leveraged is going to be lower, going forward. Hence, the question is whether higher capital

requirements will (1) be sufficiently high to prevent a financial crisis, and (2) whether the relevant areas of financial intermediation will be subject to higher capital requirements (derivatives).

Institutions or asymmetries (page 27): The discussion focuses on investment as gate keepers to firms issuing stock. While the argument that there are distorted incentives on the part of investment banks in terms of deciding who can issue stock, I think a more fundamental reason why some firms are traded, and some are not traded, or are traded more thinly, is because of asymmetric information (a la Akerlof, Stiglitz). That is, firms in general know more about their own conditions than the potential lender, and a pecking order exists such that the cost of acquiring external financing is much higher than internal funds (retained profits). That is why collateral constraints exist – larger firms are able to access external funds because they have assets that can be seized in the event of default.

Public investment (page 30): The case for greater public investment in infrastructure is well developed and documented. We know the return to an additional unit of spending in public capital is generally quite high (Aschauer). The question is whether the government, or a quasi-governmental unit can implement the investment efficiently. I think the case that it can has to be documented more comprehensively.

Government deficits (page 35): Balanced budget amendments or requirements are not typically a good idea, given the cyclicity of revenues and spending. However, it is unclear how much additional freedom would be gained by sub-national governmental authorities if they were eliminated. The fact that state governments have limited ability to increase tax revenues in times of distress, combined with the fact they do not have recourse to seignorage, means that investors would not be willing to finance large deficits. (Euro area countries prior to EMU could borrow, but they had their own monetary policies.)

Financing Small and Medium size Enterprises (SME's) (page 38): What is the experience of the SBA? The US already subsidizes financing via the Small Business Investment Corporation (SBIC).

Evaluation of creditworthiness based on historical analyses (page 41): I do not understand how this would be implemented.

The affinity of high rates of innovation with greater reliance on SME's (page 49): I do not know of any empirical evidence to this effect.