Fred Block, "Controlling Global Finance" World Policy Journal (1996): 24-33

THESIS

The secular and seemingly nonreversible increase in global unemployment is linked to the operation of the international financial system. The two key changes are the increase in international capital mobility and the innovation in financial instruments, namely derivatives.

SUMMARY

The Bretton Woods System (BWS) institutions were created to help nations avoid the unemployment problems of the 1930s, but the link between the institutions and the problems are not discussed anymore. The BWS was initially very permissive of capital controls (even the IMF could require countries to impose capital controls as a condition). The negative sides of the controls were that corporations were reluctant to invest and the opportunities for expansion of the financial institutions were limited. In general, the allocation of resources were inefficient. Expansion of global business activities created a constituency for the elimination of capital controls. Before making his argument, Block demonstrates the correlation between four periods of increasing capital mobility (periods generally corresponding to changes in the BWS) and the increase in unemployment. The key link/mechanism in his argument is the relationship between the long-term (LT) and the short-term (LT) interest rates. U.S. LT interest rates have steadily climbed in the post-war era, which permeated to other countries due to increasing capital mobility, which both equalizes the interest rates and restricts countries from devaluing to disconnect their interest rate with the world interest rate. In addition, the spread between the ST rates and the LT rates in the U.S. have grown and persisted. While this spread usually reflects inflation premium, the question remains as to why investors are able to extract this premium now more than previously, when the actual inflationary pressures were higher. Block's answer is the invention of forms of investment—derivatives—that are neither ST nor LT. Their existence allows investors to constantly extract inflation premium, creating a permanent tendency toward high LT interest rates across the international economy. The high interest rates directly lead to higher rates of unemployment and slower rates of growth. The high interest rates in the 1980s following the heavy borrowing by developing countries in the 1970s led to the debt crisis. Unfortunately, high interest rates also keep governments from deficit spending during periods of recession., because governments have to free resources for debt service, they have to cut other types of spending, such as investment in infrastructure. Thus the weakening of government spending, consumption and investment lead to slower sales growth and slower growth in profits. Corporations are discouraged from investing in new projects, and they become "lean and mean." The usual counter argument to this slowdown from the high interest rate is that the economy would not have been able to sustain a higher rate of growth without inflationary pressures. Block doesn't buy this argument because he thinks that societies have the capacity to develop new institutional mechanisms to hold inflation in check. As for reforming the system, Block suggests the following: 1) Lower global interest rates, so both public and private sectors can finance new initiatives. 2) Expand the availability of financing to noncorporate borrowers in both the developed and the developing worlds. Three specific types of necessary reform are: return to more stable exchange rates a la BWS; add measures to increase the TC in the foreign exchange markets and in the derivative markets (e.g. Tobin tax); increase international agreement on the legitimacy of national or regional capital controls. Lastly, Block argues that the corporate demand for new investment will continue to be low, while the non-corporate demand for new investment will be high. Therefore, he argues that the financial system needs to be reformed to facilitate lending to those noncorporate entities and to increase investment in human capital.