

## Relaxing the International Constraints on Full Employment: A Comment

I. The authors ask themselves how an individual country could manage to pursue an independent full employment policy in an unpropitious international environment. I should like first to say a few words on why this environment is so unfavorable nowadays. For practical purposes the flow of capital between countries is uncontrolled or uncontrollable. The amount of such funds which are subject to quick movement from country to country is enormously large in relation to the reserves which are at the command of governments and central banks. Countries are strongly divided between surplus and deficit countries. The exchange rates are unstable. The world of free financial flows was originally created by the United States who then had reason to think that it was to its advantage. In the meantime the world has changed and, in part at least, the advantage has passed to Japan and Germany. The U.S. is in a hybrid position: It is a creditor to Latin America and a debtor to Japan and Europe. The dollar still has a unique position as a widely accepted and trusted asset with all the advantages which this confers on the U.S. monetary policy, yet it cannot serve as a standard or basis for other currencies; New York is still the first centre, but U.S. does not provide a lender of the last resort. The IMF which prescribes strong doses of restriction to suffering debtors certainly does not fulfill this role. The position of the world is thus in some respects not unlike that of the early thirties when, as Kindleberger reminds us, there was no financial leader (England no more, the U.S. not yet). The financial health of the world is watched over and policies are coordinated by a group of ten central bankers who meet every quarter of a year when they have their photograph taken.

This unstable position in the international field is not unconnected with the national scene where everywhere the financial sector has gained in weight and influence and has been – especially in the U.S. – the instrument of tremendous structural changes and of shifts of power and wealth. The process in which this is being brought about has been justly called the Casino Society. The result of it is a tremendous pile of debts in the corporate sector, due to the replacement of shares by junk bonds, a process which offers a certain parallel to the indebtedness of the development countries (the parallel has been drawn by G.P. Brockway in *Challenge*, May-June 1989). Altogether our world seems to be

dominated not only by finance, but more specifically by short run speculation. Autonomous economic policies are called into question by lack of control over interest and exchange rates and over capital movements.

II. What are the consequences of the tax which the authors, following Tobin, propose to levy on all transactions on the foreign exchange market? The question is hypothetical for we have no experience with such a tax. We can answer it with some confidence as far as the relation between the quotations of the exchange rate in different places is concerned. If the tax were 1/2% in Germany the price of the dollar in New York in terms of DM might be up to 1/2% higher or lower than its price in Frankfurt. Like the gold points the tax establishes a certain range of freedom where arbitrage would not work. (I assume in the context that the transaction costs are negligible.) If the price in the home market can diverge by a certain amount from that abroad this will to the same extent also permit a divergence of interest rates, because the arbitrage will not be able to equalise completely the interest on loans in, say, dollars in the two places. If the tax were variable and could be quickly adjusted then it might conceivably be used to shield the country in question against a change in interest rate in some other country which might otherwise force the first country into following this change. This would indeed constitute a rather powerful means of protecting a country's full employment policy against harmful influence from outside. It would have advantages as compared with a direct manipulation of the exchange, if it were combined with the Dornbusch proposal of not applying the tax to the current account. I cannot judge the administrative feasibility of such a variable tax, but in theory it would be a possible answer to the tyranny of other countries' interest policy. This may become clearer in the following.

The effects of the Tobin tax are much more difficult to predict once we turn to the movement of the exchange rate over time.

A great deal of speculation involves holding positions only for a very short time within the day and the speculative gains made are small for any individual transaction. The proponents of the tax assume that a speculator in a bullish market who has paid the tax (we assume that it is always the buyer who pays it) expects to recover it and make a gain, too, by selling after a short time. The tax will make it very much less likely that he has a chance to succeed in a short spell of time so that he will either hold the position for a much longer time or will not engage himself at all. The tax would thus even out small short term movements and induce speculators to hold positions longer.

This interpretation depends on the assumption that the movements of the price net of tax are independent of the imposition of the tax. But is that plausible? Let us visualize the speculative market as interposed between a supply of exchange coming from the exporters and a demand coming from the importers of goods. If we start from a state of cleared markets and assume that

an additional demand from the importers emerges then the speculators are supposed to provide the supply of foreign exchange on condition that they will make a gain. If there is a Tobin tax the gain they require will rise the amount of the tax so that the fluctuations of the exchange rate will be made steeper by the tax. To put it differently: If the tax were to eliminate gains from speculation up to the amount of the tax then the demand from the importers might not always find a ready supply and they would drive up the price until the speculation would be ready to come forward. The importers will produce such gains as are necessary to make speculation worthwhile. This may, however, not be true if the importers prefer to wait and queue up rather than pay higher prices. Similar considerations will apply to a bearish market where the buyers will deduct the amount of the tax from their offer and the decline of the prices will be reinforced in a cumulative way by the tax. Which of the two cases will materialise depends on the bargaining strength of the importers and exporters. If the importers cannot pay more than a certain amount they will cut their price offer to the speculators, if they are able to shift the cost on to the price of the goods they will bid up the exchange rate. We must consider that beside the importers of goods also exporters of capital provide an "ultimate demand" in our market. These capital exporters will in some cases be in a position to bid up the exchange rate very strongly so that they can swallow a lot of tax.

We may perhaps discern two effects of the tax: First, it will encourage speculators to hold positions longer, because executing a chain of short-term transactions will make the tax pile up, making it less likely to earn a satisfactory profit. Second, the chain of speculative transactions will be shorter and the price will move upward or downward more steeply and more quickly because the cumulative effect of the tax on multiple transactions will soon make the importer unwilling to pay more or the exporter to accept less. Thus we shall get steeper and shorter price movements and less transactions in the short run. In this sense the short term speculation (say, over the day) would be diminished while the speculation over longer periods (six or eight weeks which is considered by Schulmeister, 1988, a crucial period for the formation of speculative bubbles) may quite likely increase. These brief considerations cannot suffice to decide how the tax will operate. It may even be that we cannot foresee the actual effects without any experience of it.

III. The authors have stressed the fiscal side of their proposal. The Tobin tax could bring a large revenue to the treasury (although we have to remember that the more effective it would be in curbing speculation, the less revenue it would yield). It is probably not difficult to administrate if the control over the banks and the stock exchange can be assumed; the multinationals who act as their own banks to a great extent might be more difficult to handle.

The tax would be very attractive if we could assume that it does not hurt consumption. But if Schulmeister (1988) is right and the speculative gains are

ultimately paid by the normal trade this would be *a fortiori* true for the Tobin tax which would thus be shifted as a whole on to import prices.

Since the Tobin tax is ostentatiously directed against speculation one might well ask why it should be restricted to a particular form of it and not applied more generally to the stock and bond markets. The increased stream of payments across frontiers is after all only a symptom of the ascendancy of finance over industry (the casino society). Such an extension would deserve attention, if for no other reason but that the opposition against such a tax would no doubt come from these wider circles who would think that the tax on foreign exchange might be only the thin edge of a general speculation tax.

The authors never mention the capital gains tax although this has the same thrust against speculation as the Tobin tax; this is probably because it plays no role in this context in Europe, but it exists at present in the U.S. to the extent of 25% and it applies to the wider range of speculation. For larger speculative gains of say 6 to 8% (the averages given by Schulmeister for speculation in exchange markets where positions over a number of weeks are held) the capital gains tax would be more effective than a small transaction tax.

IV. I want to express my sympathy with Dornbusch's differentiation between current and capital balance – or between the legitimate requirements of trade and the doubtful demands of capital transfer – and his declared intention to throw, not like Tobin, sand but rocks into the machinery of international finance. Indeed, whatever the merits of Bhaduri-Matzner's proposal, it does not directly address the basic problem of international capital movements. But these are the ultimate cause of the large exchange rate fluctuations which are only overlaid and reinforced by speculation. And it is the capital movements which are the decisive danger to autonomous economic policy. They are motivated either by differences in interest rate, or by taxation, or by fear of owners for the security of their capital or by the intention to blackmail a government which threatens the interests of the rentiers.

Now it is in the nature of these capital movements that you cannot deal with them by means of a mechanism, so to say automatically, but only by discretionary measures.

It is of course true that the Dornbusch proposal involves the creation of an elaborate administrative machinery (although on the face of it this needs not be more complicated than the system of refunds of turnover tax for export which we had in the time before the value added tax). Of course, once you are able to differentiate between kinds of transactions you might just as well licence and control the capital movements directly. No doubt this goes against the grain of the entire theory and practice of our post war international financial system. There is however no way of getting round this problem. The capital movements are the equivalent of terrorism in the financial system: They are a power above governments and they are powerful because governments are unable or un-

willing to cooperate and close their ears against the claims of reason and justice.

The cooperative solution of the international financial problem is the Keynes plan for a payments union. But we have to remind ourselves that the Keynes plan in itself does not solve this problem of capital movements – the payments union would not work if they were not controlled (as Kalecki and Schuhmacher argued in the Oxford Bulletin of Statistics in 1944). In fact this problem is nowadays immeasurably greater than it was then because of the enormous mass of mobile financial capital and the perfection of the means of transferring it. In principle, however, cooperative solutions exist for this problem, too. If the country which loses the flight capital and the country which receives it would cooperate they could avoid most of the destabilising and harmful transfers. This is not completely utopian in so far as the influx of funds also constitutes a problem.

Politics, however, are not governed by good sense and fairness; otherwise governments would know that a structural surplus creates permanent trouble in the long run unless the country is willing to buy up the rest of the world. In the meantime, however, these governments are quite happy with their foreign balance surpluses, for, if they would not have them their budget deficit would have to be just so much greater in order to maintain the same volume of effective demand.

I have started these comments, and I shall also end them, by pointing out that we are in a world of transition which changes very quickly before our eyes. This fully justifies us in discussing policies and plans even if they appear to be unrealistic at the moment because they need not remain so. Indeed I think we should make a poor show if we did not do it.

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