

Relaxing the International Constraints on Full Employment: A Reply

There are two basic ideas which are shared by Professor Steindl and the authors of "Relaxing the International Constraints on Full Employment": First, foreign exchange speculation is constraining governments to design and implement programmes of fiscal expansion. Second, measures to relax this constraint can and should be taken.

There is, however, disagreement whether the authors' tax proposal TOSTAB, a variation of Tobin's original idea, can contribute to easing it. Steindl questions the efficacy of the proposal and suggests to consider instead direct capital control ("rocks" instead of "sand") or, even better, cooperation between surplus and deficit countries. I should like to discuss some of Professor Steindl's critical points.

Foreign exchange transactions originate basically from 1) foreign trade in commodities and services, 2) speculative transactions either for making gains or for protecting against losses in 1), 3) arbitrage, and 4) long-term capital transactions (direct investment and/or credits). Our proposal is aimed at the reduction in the volume of those short-term transactions, which are not connected with trade and long-term capital transaction. The proposal is based on the assumption that, by and large, the tax will be immediately shifted forward. It will result in price increases of internationally traded goods and services. Non-speculative foreign trade transactions by the banking system will allow for a "normal" profit which is part of the commission. Profit thus will remain more or less unchanged. Therefore it is unlikely that importers will be exposed to a shorter supply of foreign exchange. That would require a TOSTAB that is greater than the margin between the buying and the selling rate. It can be assumed that the margin will adapt after the introduction of TOSTAB. If this is the case, an intensification of the fluctuations of the exchange rate as theoretically expected by Steindl is not likely to take place. Steindl apparently assumes that foreign exchange speculation is all pervasive in foreign exchange trading, or, that without gains from speculation no trading would take place. This assumption is hardly justified by reality.

There is no reason to believe that TOSTAB would have any direct impact on long-term capital transactions as those are dominated by factors such as the

expected rate of return on real investment. The main purpose for suggesting TOSTAB, namely to make short-term foreign exchange transactions less attractive, appears to remain unaffected by Steindl's critique. It can be assumed that the outflow of 50 billion DM shortly before and after the introduction of the 10% tax on income from interest (withholding tax) as from 1st January to 1st August 1989 in West Germany would have been discouraged, if a TOSTAB at a rate of e.g. 1/2 percent had been effective. This capital movement out of West Germany was generously serviced by the banking system. A large part of the money transferred came from the non-speculative investors (savers). As long as the fundamentals of an economy are characterized by superior competitiveness, a substantial outflow is unlikely not to be reversed in the medium-term. The essence in TOSTAB is intended to improve the conditions of the real economy *vis-à-vis* the financial sector: Steindl's argument does not prove the contrary to be true.

TOSTAB is not regarded by the authors as a panacea. They are aware that it offers no shield against a capital flight which is caused by a fundamental distrust in the political and socio-economic conditions of a country. It is a device designed for more normal times. TOSTAB is certainly to be regarded as inferior to a cooperation between surplus and deficit countries against short-term speculation, as again suggested by Professor Steindl. Its advantage is, however, that it can be introduced unilaterally by a single surplus country even before a multilateral agreement can be achieved.

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