CREI Working Paper no. 1/2010


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available online at http://host.uniroma3.it/centri/crei/pubblicazioni.html
ISSN 1971-6907

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1. Introduction

It is a common feeling that mechanisms best function when they are properly greased. So why should one feel the urge to cast sand in their wheels to let them work better?

The answer may depend on the nature of the specific mechanism and on the fact that the device is asked to serve very different masters. If you think of global finance, for example, you may discover that it is a very special mechanism: on the one hand it gives the opportunity to seek for the most efficient use of capital; on the other, it may jeopardize the effectiveness of public interventions in the economy. It may signal - but even generate - unexpected shifts in confidence, amplify economic downturns, ignite and transmit negative effects from the monetary to the real economy. Currency crises, in particular, may reflect the unpredictable mood of anxious speculators in search for profit maximization (or loss minimization) but even “inconsistent and unsustainable macroeconomic policy stances” (Rajan 1999: 12).

The aim of this paper is to review the literature on the proposals for “sand in the wheels” of global finance, along the lines first suggested by James Tobin in 1972, i.e. with a tax levied on all capital foreign transactions. Nowadays, a very few economic concepts are as popular as the Tobin tax. But for decades it was widely ignored by “the community of professional economists”, and occasionally taken into consideration only by “journalists and financial pundits” (Tobin 1996: x).

The methodology of enquiry we adopt is to follow, under the evolving threads of both the emerging of recurrent crises and the European and international integration processes, the debate on the implementation of a tax on transactions in foreign currencies, from its first suggestion until recently. We believe that the time, space and institutional coordinates of debates on economic theories, that is the changing context in which they emerge and evolve, are a fundamental element for their proper understanding and this will prove particularly important for the case of a Tobin Tax.

The next section will be devoted to a reconstruction of the historical context when the first proposals by Tobin (1974; 1978) were published. The third section will
explain such proposals in detail. Sections from four to six are devoted to the subsequent debate, before some concluding remarks are made.

2. The Historical and Theoretical Context
During the Sixties, the USA experienced a period of steady economic growth and the so-called New Economics brought the new-Keynesian theory, aimed at active stabilization policies, into the very heart of policy-making. James Tobin was a member and later advisor of the US Council of Economic Advisers under Kennedy’s Presidency. As Tobin himself remembers in his autobiographical note written for the Nobel Prize ceremony:

The Kennedy Council recruited a remarkable staff, including Okun, Solow, and Arrow. Our collective magnum opus is the 1962 Economic Report, a full statement of the theory and practice of the policies for stabilization and growth associated with what the press then called the "new economics". Work at the Council was demanding, exciting, and sometimes frustrating. But our advice gradually gained a large measure of acceptance, and by the end of 1965, our basic macroeconomic goals were achieved. Alas, these victories were lost during the Vietnam war and the stagflation of the 1970s. (Tobin 1981)

In fact, between the end of the Sixties and during the Seventies the US economy experienced a long period of crisis, culminated with the hitherto unknown phenomenon of stagflation. The Vietnam war, the huge disequilibrium in the balance of payments, the difficulties connected with the increasingly unstable Bretton Woods regime and the turmoil after its collapse, constitute the background on which the two oil price shocks developed, leading to a dramatic worsening of the macroeconomic framework.

The negatively inclined Phillips curve seemed unable to survive the test of data and a new school of thought emerged, the New Classical Macroeconomics, becoming shortly the mainstream economics. The previous attempts made by the US Government to reduce the rate of unemployment, with a large use of expansionary policies, seemed to be patently responsible for the high rate of inflation; on the other hand, they proved ineffective to solve the problem of rising unemployment. The Keynesian economic theory that justified state intervention and minimized the importance of inflation proved outdated and, in a way, even responsible for the bad performances of the US economy.

1 Although other co-causes could be taken into consideration (Kaldor 1976; Mundell 1969; Kouri et al. 1978).
2 The usual story is that, already in the ’60s, from a number of empirical studies, the relationship singled out by the Phillips curve appeared less stable and many countries experienced an increasing level of inflation without any decrease in unemployment. As it is well known, Milton Friedman and Edmund Phelps allowed only for a short-run tried to explain the Phillips curve through the use of adaptive expectations and came to the conclusion that the curve was working, but only in the short run. In the Seventies, the phenomenon of stagflation and the introduction of the rational expectations hypothesis by Lucas, instead of the adaptive expectations, marked the negation of any inverse correlation described in the Phillips curve.
The increasing rate of inflation jumped at the top of the public worries. As underlined by president Carter, during his mandate 1977-1981 inflation had become the public enemy number one. It was necessary to intervene. As is well known, this widespread awareness led, on the political level, to appoint Volcker (with his anti-expansionary attitude) as Chairman of the Fed in 1979 and, at the academic level, to the triumph of monetarism and the new classical macroeconomics. Given the assumptions of rational expectations and perfect agents’ foresight, in order to solve the problem of stagflation it was necessary to operate mainly on the inflation side, via a strict control of money supply; on the fiscal side, the government had better abstain from rising public expenses and interfering with the operation of the markets.

From the point of view of the global economy, the collapse of Bretton Woods transformed the international monetary system based on fixed exchange rates, the dollar-exchange standard, into a system of flexible rates. In the Bretton Woods system, currencies were pegged to the dollar and the dollar was the international reserve currency, the only one convertible into gold. In order to ensure international liquidity, it was necessary to have a balance of payments deficit in the USA, while US monetary and fiscal policies were rather free from external pressures. According to Triffin (1960), such a dilemma was indeed the motive behind the breakdown of the system. The shift from fixed to flexible exchange rates had as its first and most evident result the devaluation of the dollar\(^3\), especially against the German mark and the Japanese yen.

Although the decline of the dollar against the chief currencies was a reason for concern\(^4\), floating exchange rates were not substantially questioned on a global scale\(^5\). As underlined by Frankel, “in the 1970s the majority view among economists was that floating exchange rates were the right way to avoid misalignments such as the overvaluation to which the dollar had become increasingly subject in the 1960s” (Frankel 1996a: 153).

This does not mean that there was a complete agreement on the advantages of floating rates. There were two main reasons for concern. The first was excessive currencies volatility, which endangered the smooth functioning of the trade system, especially in “local” contexts of high economic interdependence. This was the case of Europe. With regard to the European Countries, the collapse of the Bretton Woods system compelled them to start thinking more seriously to a different, more European, management of the exchange rates: the floating of the exchange rates was considered detrimental for the European monetary stability and even for the

\(^3\) On the possible reasons for the weakness of the dollar see Kouri et al (1978)

\(^4\) See Bordo, Eichengreen (1993).

\(^5\) An important contribute to the positive consideration of the flexible exchange rate regime was given by Milton Friedman (1953) who, since the ’50s, argued that speculation, in presence of floating exchange rates, is stabilizing rather destabilizing for the international system And Harry Johnson (1969: 13) wrote: “flexible exchange rates are essential to the preservation of national autonomy and independence consistent with efficient organization and development of the world economy”. Under this approach, the crisis of Bretton Woods was a clear proof of the troubles determined by fixed exchange rates.
survival of the European Communities. This explains why the European countries
gave rise to a series of experiments which in 1979 brought to the creation of the
European Monetary System (EMS) and later to the Economic and Monetary Union
(EMU). Such results were not contrary to the new economic and policy consensus.
If there is no trade-off along the Phillips curve, expansionary monetary policies
have no real effects and the cost of “tying one’s hands” (Giavazzi, Pagano 1986)
with an external constraint on currency and monetary aggregates is virtually zero
(actually, it provides incentives for fiscal and monetary discipline and helps im-
porting credibility on virtuous policy commitments).
The second reason for concern was the higher and increasing importance of specu-
lative capital mobility worldwide, a major cause of the instability of the currency
market, which reduced the autonomy of national monetary and budgetary authori-
ties.
Since the late 1950s, the capital markets developed remarkably and the increasing
inflows and outflows of short-term foreign capitals imposed dramatic pressures on
the fixed rate system. For this reason, under the Bretton Woods system the capital
flows were kept under severe controls that “were viewed not only as an instrument
of exchange rate stabilization, but as a means to secure full employment and other
national economic priorities” (Simmons 1999: 38): such controls provided the ne-
cessary insulation from external constraints and let domestic expansionary policy
be most effective.
After the collapse of the Bretton Woods regime, quantitative capital controls be-
came less viable and manifest. A slow process of controls removal took place all
over the world during the ’70s and ’80s6. At the same time, the emergence of the
Eurodollar market, the growing mobility of financial capital, the increasing dime-
nsion of capital flows and the consequent speculation were major causes of insta-
bility affecting the international economy.

3. The Birth and Childhood of the Tobin Tax

3.1. The Birth
It is in this troubled context that James Tobin develops his idea of a tax, subse-
quently named after him, designed to prevent or limit the instability of the interna-
tional monetary system. His proposal was first put forward in 1972, in the third of
the Eliot Janeway Lectures, Prospects for Macroeconomic Policy, held at
Older.
Its emergence is rather known: Tobin himself underlines in 1995 (Eichengreen et
al. 1995: 165) and again in 2001 (Tobin 2001) how the proposal stemmed from an
extension to the international monetary system of the passage of Keynes’s General

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6 In 1974 the Unites states removed the controls built since 1963. Many other countries followed the
USA.
Theory, where he distinguishes “speculation” from “enterprise” and designs a transaction tax to discourage short-term financial speculators. If one reads the lecture, it is clear also that Tobin is still inspired by the Keynesian optimism for fine-tuning stabilization policies:

I believe that the original hope of the New Economics can be fulfilled. That is, active fiscal and monetary policies, dedicated to economic ends and liberated from extraneous taboos, can keep the economy growing within a narrow band of full employment (Tobin 1974: 100)

Let us follow his reasoning. Making use of the open macroeconomic Mundell-Fleming model, Tobin (1974: 77ff) recalls how, under flexible exchange rates, the monetary policy – which he deems more powerful and rapid than fiscal policy in terms of stabilizing effects – should have greater impact than under fixed rates. Under fixed rates, interest rates decreases will result in capital outflows and the need to intervene with the reserves. But also under flexible exchange rates any expansionary monetary (even fiscal) policy will be ineffective. It is usually acknowledged that in an open system with high capital mobility, diminishing interest rates will not directly push the aggregate demand through domestic investments but through the indirect effects on the current accounts of exchange rates changes: “movements of exchange rates in response to capital flows is a substitute for the movements of international reserves in a regime of fixed exchange rates” (Tobin 1974: 90). In the context of perfectly mobile capital, any unilateral decrease in the interest rates is supposed to determine a capital outflow which causes a depreciation of the exchange rate and therefore a rise of competitiveness and exports. But this mechanism is weak. In a repeated international game, the other countries will retaliate in expansionary monetary policies which bring about competitive depreciations and jeopardize the trade balance effect. And this may happen not (only) in response to dramatically not-credible, unsustainable expansionary policies, but even due to the changing expectations of such credibility and sustainability by the

7 In Chapter 12 The State of Long Term Expectations one can read: “The introduction of a substantial government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States” (Keynes 1936: 160).

8 In an interview given to Der Spiegel in September 2001, in reply to the question What impelled you to develop the Tobin tax in 1972?, Tobin answers: “First, I am a follower of Keynes who, in his famous chapter 12 of his "General theory" on the stock crash of 1929, had suggested a turnover tax to marry investors more durably to their assets. In 1971, I applied this tax to the foreign exchange markets. The United States departed from the Bretton Woods system of fixed exchange rates. At the same time, electronic transactions promised to bring an enormous increase in the speed and the number of transactions. I wanted to slow this process down so that there wouldn't be so much speculation and so much volatility in the exchange rates. Now that anyone can make financial deals at any time on his home PC, problems I foresaw have grown by multiples” (Tobin 2001). On the Keynesian roots of the Tobin tax see also Variato (2003). Other information on the birth of the Tobin Tax are in an interview Tobin gave to Shiller (2000: 884 ff).
average worldwide speculator. Expectations may spread and reinforce, jeopardizing the domestic effects of active stances. The mobility of financial capital reduces the possible differences in the interest rates among countries and therefore limits the control by Central Banks and Governments over monetary and fiscal policies. The birth of the Eurodollar market has the visible effect to unify “the short term money markets of the major countries on both sides of the Atlantic” (Tobin 1974: 85). Tobin remarks the negative effects of the growing interconnection among countries through the internationalization of financial markets, what he would later call the “excessively efficient international money markets” (Tobin 1978: 520). Such worldwide interdependence has, as first and most important result, the loss of national autonomy. But national autonomy in fiscal and monetary policies is an essential element for Tobin due to the different conditions, needs and preference of the various countries. Irrespective of the exchange rate regime, in order to avoid the negative effects of sudden capital outflows, national monetary authorities have two alternatives: to rise the interest rates, with a negative impact on domestic investments and consumptions; or to impose some kind of capital controls: “whatever the [exchange rates] system […] we need to protect national autonomy in stabilization policy by deliberately contrived obstacles to international flows of funds [and] international co-ordination of interest rate policies will be essential in a regime of floating exchange rates, no less than in a fixed-parity regime” (Tobin 1974: 92).

The suggestion is to throw some sand in the wheels of the financial market, allowing some room for expansionary domestic manoeuvres without fears of sudden capital outflows: “One possible measure would be an internationally agreed uniform tax, say 1%, on all spot conversions of one currency into another”.

3.2. The Childhood
At that time, as he recalls (Tobin 1978: 521), “the idea fell like a stone in a deep well”. Indeed, the content of that lecture passed almost unnoticed.9 Five years later, in 1977, Tobin gives the presidential address at the Conference of the Eastern Economic Association10, titled A Proposal for Monetary Reform and the text is published in 1978 in the Eastern Economic Journal (later published also as Cowles Foundation Paper 495 with the title A Proposal for International Monetary Reform) where he incorporates and develops the text of his previous article. The reason for this second attempt is well explained by himself (Tobin 1978: 521):

9 We have found really a few reviews of that book and even less references to the suggestions made there by Tobin.
10 As one can read on the web, “Headquartered in New Rochelle, New York, the Eastern Economic Association is a non-profit organization established to promote scholarly and educational exchange on economic affairs and encourage freedom of research and discussion. To achieve these aims, it holds an annual conference and published the Eastern Economic Journal. Many pluralistic associations hold their annual meetings within the organization's framework”: http://www.syl.com/travel/organizations/economic_organizations/eastern_economic_association/.
“If I cast it in the water again, it is because events since the first try have strengthened my belief that something of the sort needs to be done”.

In those years, the economic debate mostly concentrated on the flexible exchange rates as the main cause of instability. Some economists and businessmen even participated in a true “nostalgia […] for the gold standard or its equivalent, for a fixed anchor for the world’s money, for stability of official parities” (Tobin 1978: 519).

Tobin reaffirms that the instability of the world economic system is not due to the exchange rate regime; rather, the debate on the regime “evades and obscures the essential problem [i.e.] the excessive international - or better, inter-currency - mobility of private financial capital” (Tobin 1978: 519). Hence the proposal, again, to introduce a tax on “all spot conversions of one currency into another, proportional to the size of the transaction. […] A 1% tax” (Tobin 1978: 521) that is designed to discourage daily speculative and destabilizing roundtrips among foreign currencies without damaging long-term foreign direct investments and trade. At least three elements are worth being underlined.

The first is the distinction between “mechanical” and “economic-informational” efficiency of markets. The idea of a tax on currency transactions can arise only if the market mechanism is not considered perfectly efficient or not able to guarantee some kind of socially desirable result. In this case, when some failures of the markets are taken into consideration, means to overcome those deficiencies are to be dealt with. This point is clearly underlined by Tobin when he describes the concept of market efficiency:

What we have is an incredibly efficient set of financial markets in which various obligations, mostly short-term, expressed in various currencies are traded. I mean the word ‘efficient’ only in a mechanical sense: transactions costs are low, communications are speedy, prices are instantaneously kept in line over the world, credit enables participants to take long or short positions at will or whim. Whether the market is efficient in the deeper economic-informational sense is very dubious (1978: 624).

In fact, as he remarks, it is dubious that “the price signals these unanchored markets give are signals that will guide economies to their true comparative advantage, capital to its efficient international allocation, and governments to correct macroeconomic policies” (1978: 525). The main problem he identifies is that in those markets “speculation on future prices is the dominating preoccupation of the participants”. In the “ideal world of rational expectations”, he notes, speculation is “the engine that moves actual rates to the equilibrium set”. But in the real world, where expectations are far from being rational, nothing assures that the markets move towards the equilibrium; on the contrary, they are likely to deviate from equilibrium along different paths. These paths, that may be “innocuous in markets – as for rare coins, precious metals, baseball cards (...) – which are sideshows to the real economic circus […] are far from innocuous in foreign exchange markets whose prices are of major economic consequences” (Tobin 1978: 524). Tobin recognizes that the tax he was proposing was likely to produce some forms of distortions, as
any other form of taxation does, but he considered them “small compared to the world macroeconomic costs of the present system” (Tobin 1978: 525).

Another key element of his reflection concerns the question of enforceability. Tobin recognizes that the device must be “an universally agreed uniform tax” (Tobin 1974: 89). Otherwise, it would be ineffective and would damage the countries that decide to adopt it unilaterally. He also conceives the possible “ingenious patterns of evasion” but “since these will not be costless either, the main purpose of the plan will not be lost” (Tobin 1978: 525).

Actually, and here we come to the third point worth underlying, a coordination among the national authorities worldwide is anyway inescapable. Governments cannot avoid “the task of policy coordination with a longer-range and more global view of their responsibilities” (Tobin 1978: 526). In this respect, the first-best solution would be a “common currency, common monetary and fiscal policy and economic integration” although this is not a “viable option in the foreseeable future, i.e., the twentieth century” (Tobin 1978: 520).

Tobin also stresses that the internationalization of capital market involved a rather high degree of integration among different countries, but such form of integration “is partial and unbalanced; in particular private financial markets have become internationalized much more rapidly and completely than other economic and political institutions. That is why we are in trouble” (Tobin 1978: 521). The internationalization of financial markets was not backed by an analogous and necessary internationalization of institutions and this fact prevented the reaching of the first best-solution.

4. From Benign Neglect to Misdirected Criticism?

As we have previously underlined, during the 1970s and large part of the 1980s the new classical macroeconomics was taking the lead in the economic profession against the Keynesian macroeconomics. The free functioning of market mechanisms, the rational expectations hypothesis and a minimal role of Government in the economy were told to be able to assure the optimum in terms of equilibrium, full employment and growth. In such a theoretical context, the proposal by Tobin, who was suggesting an active and important role of public authorities in the market, could be only considered inappropriate and out of date. This explains why, for instance, the 1974 book was hardly ever taken into consideration.

The remark made by Tobin in 1978 before the Eastern Economic Association passed less unnoticed. Some time had passed since the introduction of flexible exchange rates after the Bretton Woods collapse and the international situation was worsening. As explained Rudiger Dornbusch in the early ‘80s:

> after ten years of experience with flexible exchange rates there is much less confidence that flexible rates and domestic policy autonomy are reconcilable. Quite on the

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11 “Our economies and governments are not sufficiently unified in other respects – goods, labor, and capital markets, taxes and fiscal policies – to live with a single area-wide monetary policy” (Tobin 1974: 88)
contrary, exercise of policy autonomy becomes near impossible because many countries are too small and open to accept the exchange rate variations induced by policy. Alternatively, in the case of large countries, the effects of policy are exported abroad and come to interfere with foreign internal stability. (Dornbusch 1982: 2)

In those very years, the volatility of the currency market led to several attempts by the leading Finance Ministers and Central Bankers of the most industrialized countries to start a series of informal meetings in order to prevent major negative impacts on trade. After one of such meetings, The Economist publishes in October 1985 a long survey dedicated to Monetary Reform. The report wondered whether exchange rates overshooting due to capital movements would damage trade or if “sooner or later exchange rates bow to trade”. The Tobin Tax is cited (and quickly dismissed) under point b) among many alternative policies: a) interventions by Central banks on the currency market; b) taxes and controls on capital movements; c) policy coordination (p. 48).

But apart from this (sole) appearance in the press, the increasing instability of the international monetary system brought some new attention on the proposal to throw some sand in the wheels of global finance. Attention but not praise indeed. In fact, references to Tobin’s 1978 article in the economic literature of late ‘80s are rather common; at the same time, they are mostly critical.

Some Authors (Dornbusch 1982; Frenkel 1988; Cooper 1984; Aliber 1984) consider Tobin’s suggestion, albeit ideally appropriate, as not practically viable, due to the high possibility of evasion and the consequent necessity that the tax be applied only universally. This global option is, nevertheless, considered unrealistic for a problem of collective action and incentives to free-riding: “an incentive always exists for some country not to impose the tax and thereby to capture much of other countries’ business” (Frenkel 1988: 13). Allsopp (1987), Summers and Summers (1989) in particular underline how its capacity of enforcement would be too weak.

At the same time, many aspects of the Tobin Tax are considered critical (Dornbusch 1980; Frankel 1983; Frenkel 1988) and such a tool is deemed to be an ineffective - or even damaging - measure, because it reduces the benefits of the full liberalization of capital markets and produces distortions in the good functioning of free trade.

An interesting critique is made by McKinnon (1988). He shares with Tobin the conviction that exchange rates volatility is an evil to be eradicated; even with the newly invented financial instruments, a complete assurance of long-run investments on forward markets against currency risks is impossible: “short-term hedging on a noncontingent basis covers only a small proportion of the potential longer term exchange risk arising from investment decisions that are made today. In effect, incomplete forward commodity markets exposes industrialists, with long-term fixed investments to foreign exchange risk which they cannot avoid.” (McKinnon 1988: 90).

But he also argues that the proposal by Tobin is absolutely negative if the full advantages of global trade are to be secured. It has to be rejected because it does not properly address the right goal, i.e. a common monetary standard: “Without a
common monetary standard, the remarkable integration of Western European, North American, and the industrialized Asian economies in both commodity trade and financial flows is less efficient, and becoming untenable” (McKinnon 1988: 84). At the same time, Tobin is accused of “restricting the operation of the international capital market to support monetary nationalism” (McKinnon 1988: 100).

This contribution by McKinnon is interesting because, for the first time, it envisages an explicit opposition between a Tobin Tax and a process of institutional re-shaping of the global economic and financial order, the former being a sort anti-historical and backward looking direction, the latter being the future of the world order. As we will see, this question would become a recurrent and increasingly important feature in the more recent years.

Although, as we have seen, most critiques (and this latter by McKinnon shows it very well) were actually anticipated by Tobin himself (showing a sort of mis-directed criticism), although analogous proposals were cast into the debate in those very years (Stiglitz, 1989; Summers ands Summers, 1989) to sustain his idea, and although “the pendulum [of economic theory, earlier believing that] the market knows better than governments what is the true value of the currency [, …] began to swing back in the 1980’s” (Frankel 1996a: 153), the academic reactions on the Tobin Tax were still very cool.

5. Financial Crises and Global Public Goods: the Golden Age of the Tobin Tax

The 1990s are marked by severe currency and financial crises: the European Monetary System (1992-93); Mexico (1994); East Asian Countries (1997), Russia (1998), Brazil (1998-99), Argentina (1999-2000). The causes and evolution of those crises are very different and are explained by many heterogeneous theoretical models, but they are all clear signs of the substantial instability of both the financial and currency markets: instability grown together with the increasing interconnections among countries due to the process of globalization. In 1995, “while world exports of goods and services totalled about $6.1 trillion, the daily foreign exchange market turnover amounted to about $1.2 trillion – that is, about fifty times as much annually” (De Angelis 1999-2000: 187).

The emergence of such crises, with their detrimental effects upon both the domestic economies and the international monetary system, attracts a renewed interest for the Tobin Tax. Between 1995 and 1998 the debate blows up in flames (Eichengreen, Tobin, Wyplosz 1995; Felix 1995a; b; Garber, Taylor 1995; Dooley 1996; Eichengreen, Wyplosz 1996; Frankel 1996a, b; Haq et al. 1996; Kaul, Langmore 1996; Spahn 1996; Stotsky 1996; Tobin 1996; Arestis, Sawyer 1997; Dornbusch 1998).

The misdirection of most of the criticism in the economic literature towards his original proposal convinces Tobin to attempt to make himself properly understood. His strategy consists of three main steps: he looks for scientific support in other authoritative scholars; he tries to take into consideration some new features of the international financial system and integration processes; he enlarges the scope of the tax to consider the question of raising money to finance the production of global public goods. In fact, after a personal, invited contribution to a UNDP Report
on Human Development in 1994\textsuperscript{12} where the proposal is restated, the first important contribution of this new academic debate is a paper by Barry Eichengreen, Tobin himself and Charles Wyplosz\textsuperscript{13}, published in The Economic Journal in January 1995. The aim of the proposal is clearly restated:

The principal purpose of the tax is to expand the autonomy of national monetary policies. That does not depend on its success in reducing volatility. The tax would not, of course, permit national macroeconomic authorities to ignore the international repercussions of their policies. In particular, it could not protect patent misvaluations in exchange parities; speculators' gain from betting on inevitable near-term realignments would far exceed the tax costs. Nor would the tax make macro-economic policy coordination among major governments unnecessary or undesirable. (Eichengreen, Tobin, Wyplosz 1995: 165)

But the most interesting aspect of that paper is the recognition of the European process of economic and monetary integration as a strategic case study to test a transaction tax on foreign currencies. Under the Bretton Woods regime, in the European countries:

voters were more tolerant of the economic consequences of misaligned exchange rates because postwar reconstruction and 'catch-up' afforded singular scope for growth. With the industrial countries growing rapidly, their governments felt little need to engage in discretionary monetary and fiscal policies. In these circumstances, voters were little disturbed by the costs of misaligned currencies. The political insulation thus conferred on governments enhanced the credibility of their commitment to pegged rates. (Eichengreen, Tobin, Wyplosz 1995: 163)

Nevertheless, time has changed and after the 1992-93 Erm crisis, when the weakest currencies are forced out of the band and the band itself has to be widened to 30% around the central parities, some device to smooth intra-European currencies speculation becomes necessary to manage the transition towards a complete monetary union:

Members of the European Union, for whom Maastricht's deadlines loom, cannot await a global solution. They must proceed before receiving assurances that other countries will follow. Hence we recommend that they apply a tax or deposit re-

\textsuperscript{12} See “A tax on international currency transactions”, in UNDP, Human Development Report 1994, Oxford: Oxford University Press. This contribution gave rise to a vivid political debate in the US Congress, where a a bill was introduced to prohibit any such taxes (Raffer 1998: 529).

\textsuperscript{13} The new colleagues who join his proposal show a clear scepticism towards the self-regulating capacity of markets: in a paper of 1996 they underline how markets are unavoidably far from perfection; they have a number of distortions (asymmetric information, moral hazard, multiple equilibria) and a restriction on capital mobility may (within certain limits) be useful (Eichengreen and Wyplosz 1996). In a previous paper (1994) Eichengreen, Rose and Wyplosz had published a CEPR Discussion Paper titled Speculative Attacks on Pegged Exchange Rates where they argued that, after the experience of the Erm crisis, it had become clear that the increasing mobility of capital had raised the risk of self-fulfilling attacks on currencies, with major damages to the real economy.
quirement to all domestic-currency lending to non-residents to discourage all speculative sales of that currency equally, regardless of the market in which they are booked. […] a speculative attack which forces a country to devalue or to suspend its membership in the ERM during the last two years may effectively rule out its participation in EMU. (Eichengreen, Tobin, Wyplosz 1995: 166)

It is a second-best instrument which may better serve the cause of easing the achievement of the first-best one: “this proposal […] is for a temporary measure to be applied exclusively by countries en route to EMU, since monetary union offers them a permanent solution to the problem posed by exchange rate fluctuations.” (Eichengreen, Tobin, Wyplosz 1995: 167).

Notwithstanding this new, authoritative contribution, at the end of the same year, the UN publishes the World Economic an Social Survey 1995 where it is emphatically stated: “The world economy is in the strongest condition in many years” (UN 1995: 12) and where the Tobin Tax is dismissed as “a sort of Luddite proposal”\(^{14}\), in the sense that it is an anti-historical attempt to contrast the increasing liberalization of markets.

The reply comes in the following year, 1996, with a book published by Haq, Kaul and Grungberg on The Tobin Tax. Coping with Financial Volatility is introduced by a prologue written by Tobin. He starts observing that the features of the international financial system have worsened further since 1972 and 1977, although the shifting of transactions to tax free jurisdictions is “overblown”. To make the proposal more viable, Tobin abandons the requirement of universality and embraces the possibility of an adoption by a set of core-countries: “the already existing attractions of low-cost sites for financial dealings do not seem great enough to drive activity away from London, New York and Tokyo. I doubt that the transactions tax would move them either. Perhaps agreement on tax among G-7 countries and a few other financial centres (...) would suffice” (Tobin 1996: xiv).

Another critical point is that financial instruments themselves have changed. Tobin therefore recognizes that there are new forms of transactions (forwards, swaps and so on) that should be taxed together with the spot transactions considered in his seminal papers. Although the invention of new forms of transactions could be a never ending process, Tobin thinks that “what is important is to tax transactions that make the exchange rates for trade in goods and services volatile and transactions that perfect the arbitrage between the interest rates relevant to monetary policies” (Tobin 1996: xvi).

He then comes to a new argument which was gaining room in the debate: the question of the amount and management of the revenue that the tax is supposed to raise\(^{15}\). He recognizes that “raising revenue has never been my main motivation” although “for the advocates of the tax this is the principal motivation” (Tobin 1996: xvi). Considering this possible attribute of the tax he explains why “the revenue will be lower than expected”: first, the tax should be lower than originally thought,


\(^{15}\) This point had been already extensively discussed by Felix (1995a; b).
not more than 0.25%, preferably 0.1%; second, it must be considered the fact that the tax may induce a reduction in the volume of transactions, that was the objective he originally had\(^{16}\); third, only a part of the volume of the foreign transactions worldwide should be taxed if his suggestion “that banks and dealers be taxed only on changes in their end-of-day open positions were adopted” (Tobin 1996: xvii).

An important question connected to this aspect is to whom the administration of the tax is assigned. Tobin (1994) had already suggested that such a competence should be given the IMF: “Each IMF member would be required, as condition of membership and of borrowing privileges to levy a tax in compliance with IMF specifications. (...) [Of course] Implementing this measure would require amending the Fund’s articles of Agreement” (Tobin 1996: xiv). A part of the tax would remain within each country, but a part would turn to the IMF for international purposes (not better specified\(^{17}\)). As put by Tobin “I do believe that a well functioning international monetary and payments system is a public good to which national members could legitimately be expected to contribute” (Tobin 1996: xviii).

In a long review article to the book, *The Economist* observes: “Some economists are showing new interest in an old idea”\(^{18}\). But, once again, this does not imply praise. The subsequent debate shows that the revenue-raising aspect\(^{19}\) of the Tobin tax is where the pros concentrate (Frankel 1996b; Kaul and Langmore 1996; Arestis and Sawyer 1997).

The critical remarks point at four major elements. First, it is widely recognized that financial markets are highly volatile and eventually unstable, but in most cases it is not the “excessive” technical efficiency of the market in itself to be criticized but the backwardness of economic and political institutions of the countries involved in the crisis. Accordingly, a tax that interferes with the functioning of the market is likely to produce distortions and inefficiencies (Dooley 1996; Frankel 1996b; Dornbusch 1998). Furthermore, it is likely to reduce the taxable basis, rather than the exchange rates volatility (De Grauwe 2000).

Second, a major problem of the Tobin tax is related to its enforcement and implementation (Dornbusch 1998; Edwards 1999; Elek and Wilson 1999; Kasa 1999; De Grauwe 2000). As noted by Eichengreen and Wyplosz (1996: 32) the common argument runs as follows: the “Tobin tax is impractical unless all countries agree to implement it. Since Universal agreement is unlikely, the effectiveness of the tax would be vitiated (..) through the international migration of the foreign exchange market”. Besides, given the increasing innovation in financial instruments, the evasion of the tax has become increasingly easy (Garber 1996; Kenen 1996).

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\(^{16}\) He writes: “After all, the primary purposes of the tax, in my mind, depend on just such shrinkage” (1996: xvii)

\(^{17}\) To be frank, a very brief sentence might help casting some light on what he might have in mind. He in fact writes: “the currency transaction tax is not the only possible source of revenue dedicated to international purpose, or necessarily the most appropriate source. A carbon tax, for example, makes a great deal of sense” (Tobin 1996: xviii).


\(^{19}\) An interesting exception is a model where two classes of investors and speculators are ex-ante diverging on their goals and the behaviour of the latter damages the former (Palley 1999).
Thirdly, it is underlined how the evidence drawn from a number of countries that have applied capital controls (both on capital inflows and/or outflows) is rather negative and disappointing (Edwards 1998).

But a fourth, maybe more important, remark was made against the adoption of the Tobin tax and it came from Dornbusch. The tax is irrelevant in the struggle against major currency crises:

I have great, great sympathy for a Tobin Tax but I think it is utterly irrelevant in the context of currency crises, because that very, very small Tobin Tax is utterly uninteresting when I look at a 30% devaluation within the next half year. Then, I want to get my money out. It slows down the overnight traffic it does not keep money in a place where it shouldn’t be. So, any belief that a Tobin Tax fits into the discussion of currency crisis, of Asia – a Tobin Tax works when people say, “You know the next few days are not really good and I am leaving for a moment before quickly coming back”. Those people would be kept in by a Tobin tax. But anyone who believes that, “This ship is going to sink and I am leaving, and sure I might come back but only after a large correction in asset prices”, that isn’t stopped. So, I think it is a disservice to Tobin to bring him into this discussion as a solution. It’s a way to try to make a very dirty argument look respectable, it has nothing to do with currency crises. It is a wonderful proposition to make the New York Stock Market look two days ahead rather than just to the afternoon and the next morning. (Dornbusch 1998: 49).

What is required is not an ad-hoc measure for crisis management but an enforceable institutional setting for crises prevention (Davidson 1997; 1998).

By the end of the millennium, the academic debate on a Tobin transaction tax seemed to have run out of arguments, both pros and cons. Quite emphatically, Riggs and Velk (1999) could easily argue that the Tobin Tax was “a bad idea whose time has passed”. But something unexpected was hatching under the ashes.

6. The Popularisation of the Tobin Tax: from Sand to Stick in the Wheels?

On the 2nd September 2001, a few months before dying, James Tobin was interviewed by the German newspaper Der Spiegel about the recurrent mass demonstrations against the WTO after the first open revolt at the summit in Seattle, at the end of 1999. It was the acme of a process whereby the proposal of a Tobin tax had become one of the leading slogans of anti-globalisation movements.

Let’s move a bit backwards. In December 1997 Ignacio Ramonet, Director of Le Monde Diplomatique, writes an authoritative article titled Désarmer les marches where, on the wave of the Asian crisis, he calls for a popular movement against capital speculators. On the 3rd June 1998 an Association for a Transaction Tax in Help for Citizens (Association pour la Taxation des Transactions pour l’Aide aux Citoyens, ATTAC) is founded in France. Its explicit commitment was to propose the adoption of a Tobin Tax on all capital transactions. Its immediate success

20 In that interview Tobin seemed to suggest that Attac was “misusing” his name. An interesting reply was published on line by Attac France only some days later, on 12th September: http://www.france.attac.org.
should be measured by its capability to organize important public political debates: in the French Parliament and Government\textsuperscript{21}, in the Canadian House of Commons\textsuperscript{22}, at the European Parliament\textsuperscript{23}, at the US Congress\textsuperscript{24}, at the Belgian Parliament\textsuperscript{25} and many others.

If the French organization was moving along the lines of providing incentives for long-term capital investment and discourage short-term speculation, the anti-globalisation movement born at the turn of the millennium was – when not openly anarchist – more concerned with the question of worldwide redistribution of resources, a very different goal from the original one. Tobin noted in fact:

\begin{quote}
I think, they are interested in the revenues from the tax, with which they want to finance their projects for world improvement. But raising money is not my major objective. I wanted to slow down currency transactions. Revenues would only be a by-product. (Tobin 2001)
\end{quote}

In both cases, nevertheless, the Tobin Tax had become the flag of a revolt against the Washington Consensus (the IFM and the World Bank have traditionally obliged countries demanding help to open their capital markets in change of financial resources for recovery), the dominating neo-liberal cultural and political paradigm and, to some extent, against the capitalist system itself. This was explicitly stated, for instance, in the \textit{Introduction} to a collective volume published in 2003 (Weaver et al. 2003) on the proceedings of a conference held in May 2002 on \textit{Alternatives to Neoliberalism}. All this seemed to support the accusation of Grabl and Lysandrou (2003: 618) that a Tobin Tax “does not represent an instrument of control so much as an act of vandalism” against the necessary liquidity of currency markets.

\textsuperscript{21} Even on the unilateral adoption of such a tax. Nevertheless, the French Ministry of Finance at least twice (in October 1998 and September 2000) publicly reaffirmed the idea as “not feasible, impracticable and counterproductive” (http://www.globalpolicy.org/component/content/article/216/45981.html). The discussion from France spread at least into Germany, where notwithstanding strong criticism from the Finance Minister Hans Eichel and Bundesbank President Ernst Welteke, Chancellor Schröder seemed to support the idea on 4\textsuperscript{th} September 2001 (http://www.sais-jhu.edu/faculty/catalan/Work-Website/TobinTax.pdf). Then, as we all know, some days later the global agenda would change dramatically.

\textsuperscript{22} In March 1999 a resolution was passed committing the government to pass a tax on financial transactions in agreement with the international community.

\textsuperscript{23} The \textit{European Parliament Intergroupe} published on 28\textsuperscript{th} June 2000 the \textit{Proceedings of the Conference of the First Interparliamentary Meeting on the Tobin Tax} as “Capital Tax, Fiscal System and Globalisation”, edited by Harlem Desir and Glyn Ford. The \textit{European Parliament's Subcommittee on Monetary Affairs} had already had a discussion on the Tobin Tax on 6 October, 1993, with a public hearing on \textit{International Monetary Cooperation within the Framework of the Easing of Restrictions on Capital Markets} with seven papers from outside experts, together with a paper from Subcommittee Chairman, Christa Randzio-Plath. These were subsequently published by the \textit{Directorate-General for Research} (Economic Series W-12/rev. in January 1994).

\textsuperscript{24} The tax was officially proposed in April 2000.

\textsuperscript{25} On 15th June 2004 the Commission on Finance and Budget of the Belgian Federal Parliament approved a resolution committing the country to adopt the Tobin Tax in case all the other eurozone members do the same.
Notwithstanding this (sometimes confused) popularisation of the Tobin Tax, the scientific discussion remains alive. Most of it concentrates on two main questions: the first is a strong link of such a tax with the increasing urge to provide and finance global public goods; the second is a sort of trade-off between a Tobin Tax and a more general reform of the international financial and monetary system.

Concerning the first point, following Patterson and Galliano (1999), the debate has mainly addressed the question of a quantitative assessment\textsuperscript{26} of the tax revenue from a worldwide adoption of a Tobin tax (both those in favour, such as Ehrenstein et al. 2005 and Westerhof 2002, and against, Aliber et al. 2002 and Werner 2003). Most contributions (Dodd 2002, Reisen 2002) make this exercise considering the tax as a device to finance the production of global public goods, i.e. services that would otherwise never be produced on a national level: ecological subsides, health programmes in Third World countries, etc. Some also outlined a sort of roadmap for the implementation of the transaction tax worldwide (Patomäki 1999), underlining the status of global public good of financial stability itself (Barrera 2000). Such debate was definitely supported and pushed by a strong public opinion and governments pressed by some of their electorate. In March 2002, in Monterrey (Mexico) a discussion was held on the Tobin Tax at the UN Financing for Development Conference heads of state and the major international institutions met to discuss ways of reducing global poverty:

What may explain its appeal to some governments and NGOs is that even a very small tax rate imposed on such a large tax base as the foreign exchange market would, at least in theory, yield sizeable revenues to finance 'global public goods', like the environment, health programmes, poverty reduction, etc. Estimates of between US$50-250bn per year have been waved about, based on tax rates of between 0.05% and 0.25%. (Reisen 2002)

On the second aspect, i.e. the possible trade-off between a Tobin Tax and a more comprehensive reform of the global financial system, the main argument in favour of the tax is that “prevention” of the crises is to be preferred to “management” (Rajan 2000). In this respect, Montani’s (2001) contribution is particularly interesting. He argues against a Tobin tax because it does not go to the heart of the problem: supranational management of a specific set of policies, especially monetary questions concerning a dramatic reform of the global currencies system. As he writes:

the Tobin Tax is an ambiguous proposal. If the problem is how to provide the UN with resources of its own, then these should be openly asked for. The problem can be solved, provided the political determination is there, with other means. The Tobin Tax represents a treacherous instrument which national governments could use for imposing controls on capital (and people), strengthening in the end their national currencies. Protectionism is a typical instrument of the economic nationalism of the

\textsuperscript{26} Also as concerns the micro-foundations and problems relating to the tax (Mende, Menkhoff 2003) and practical implementation devices, such as a “tax on wholesale foreign exchange” (Schmidt 2001: 199).
past, which it is better not to resurrect. Protesting against anarchical globalisation must by no means offer the pretext to nationalist forces for taking the world economy back to the situation of the thirties. (Montani 2001)

Here emerges the trade-off:

Globalisation has to be governed by new supranational institutions. A world currency is a supranational institution, albeit admittedly it is not a short-term goal. However, significant steps towards a world currency can be taken, such as calling for a New Bretton Woods in order to create a new global economic order, especially if Europe is able to become a new actor in world politics. The WFM must champion a strategic objective with expressly federalist contents. Only thus will it become the critical vanguard of the world people in the making. (Montani 2001)

Montani’s words are particularly interesting because after the recent breakdown of the global financial system, many authoritative voices have called for an urgent Bretton Woods Two to restart the engine of the world economy on new globally-agreed economic and monetary rules and the proponents of a Tobin Tax will presumably have to cope with such a perspective. Notwithstanding some authoritative and institutional optimism for “re-legitimizing capital controls” (UN-NGLS 2009:8) the compatibility of the transaction tax with further integration projects worldwide will have to be better explained.

7. Concluding remarks
Economic policy can be considered the art to use a given range of instruments to pursue specific goals. Quantitative controls on capital movements; a tax on foreign transactions; more integrated economic, monetary and financial systems; coordinated open-market operations by Central Banks: these instruments can all be used, alone or in some combination, to serve at least three main goals.

The first is to increase national autonomy in policy choices: the tax via a discouragement of short-term speculation and therefore a shrinking risk of capital outflows when interest rates are cut; the integration strategy via a wide range of macroeconomic devices aiming at increasing the credibility of national commitments and via the gains from increasing trade brought about by greater economic integration, etc.

The second is to diminish national autonomy in policy choices: a tax when it is designed as an internationally managed device for distributive policies on a planetary scale; coordinated interventions when they do not aim at sterilization; integration when it is conceived as a means to diminish national public intervention in the economy without replacing it with a supra-national one.

A third objective can be seen in the recognition of the global public good status of financial stability and of other global strategic choices and when attempts are made to let them operate and be financed.

The only self-evident contradiction is between the first two policy goals. But both of them can be compatible with the third one: goals one and three are coherent with a Keynesian point of view; whereas two and three are compatible with a neo-liberal
agenda. Tobin’s original proposals of 1972 and 1977 were designed to address the first objective and only in 1996 he will also move on the third one. If we recognize these three goals, three periods can be singled out in our story on the debate about the Tobin Tax.

In the first part of the time span considered, from 1978 to 1994, the greatest majority of the economic literature ignored the Tobin Tax proposal. This may depend on the fact that the paradigm in economic theory shifted towards the new classical macroeconomics: the policy goal was to decrease the public (State) intervention into the economy; no active fiscal or monetary policy can change the performance of the economy; there is no trade-off along the Phillips curve.

A process of increasing economic and monetary integration at the local (European) level was tolerated as a possible way to implement a process of decreasing the role of the States in the market. A Tobin tax, explicitly devoted to increase national autonomy in economic policy was therefore to be neglected or criticized.

Designed to address objectives one, it was bound to lose the battle against a growing and dominating consensus on two.

The second period, from 1995 to approximately 1998, is dominated by recurrent financial crises, mostly derived from (or manifested in) wide volatility in the currency market, and by the consolidating process towards monetary union in Europe. The financial turmoil worldwide seems to be a strong evidence in favour of the proposal of a Tobin Tax and this is reaffirmed with the help of new, authoritative colleagues. Furthermore, even the trade-off with the process of monetary integration in Europe seems to disappear, as Eichengreen, Tobin and Wyplosz (1995) show that a tax on foreign currency transactions within the European Union may be adopted in order to ease the transition towards the currency union, through a reduction of intra-European currencies volatility. In the same period, the Tobin Tax starts to be considered a possible instrument also to serve the purpose of providing resources to finance the production of some global public goods.

Despite many critiques from academics, this time interval could be considered the golden period of the Tobin Tax. Objective three gains momentum and a Tobin Tax, as far as it also becomes an instrument to serve the goal of greater worldwide integration, may help achieve it and therefore gain some support even in the economic debate.

In the third period, starting from 1998, the global financial system accumulates more and huge imbalances, mainly due to an irreversible US current account deficit, no longer sustained by a stable geo-political framework. The Tobin tax becomes a popular idea among all those who show uneasiness towards the main features of the world financial, economic, monetary order. In the last decade, the Tobin Tax has become a totem and a panacea for the reduction of global imbalances, via the revenues from the tax to finance a sort of worldwide redistribution of resources.

This framework suggests at least two kinds of conclusions. The first is historiographical. From this point of view, it appears that theories are often silent when there is no political demand for them. Economists can aspire, at best, at waiting for their moment of glory, called to advice politicians. And they are in the uncomfort-
able position of playing the scapegoats when things go wrong. Misunderstandings and distortions are the rule and not the exception. This is also the case of the Tobin tax: from misdirected scientific criticism towards a sudden popularisation.

The second range of conclusions are more theoretical and, from this point of view, the question is much more complex. The financial instruments have changed much since the Seventies and the capital markets are now characterized by huge real-time and (almost) costless transactions. In the last three decades, several kinds of Tobin Taxes have been designed and even applied in order to achieve the same original goal, i.e. to reduce speculation-induced volatility on the exchange rates market but local, unilateral experiments have usually given bad results.

As we have noted, nowadays two major processes are relevant when assessing the future viability of a Tobin Tax. The first is the increasing attention on the need to finance the production of some global public goods and to manage them in the interest of the global community. The second concerns the relationship of the Tobin Tax with a more comprehensive process of reform of global financial, monetary and economic institutions.

At present, a debate on the reform of the international monetary system has just started along the lines laid down by the President of the Bank of China, who has proposed a basket version of a global parallel currency based on an extended use of the Special Drawing Rights, issued by the International Monetary Fund. It is likely that such proposal might gain consensus in the near future.

Whether the Tobin Tax is conceived as pursuing alternative goals or as a mere instrument of this goal, might prove decisive for its future, perhaps not as a viable policy but at least as a topic still for further debates. But if a new architecture in the world will eventually be able to provide financial, monetary and economic stability, Tobin’s first-best solution (a global monetary standard, which he himself considered utopian in the 20th century) will make the second-best proposal (the tax) completely useless and Tobin’s original intent would be vindicated.

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Abstract. At the end of the Seventies, a new consensus was taking the lead in economic theory on the perfect rationality of agents, the ineffectiveness of economic policies and, therefore, on the possibility to sustain experiments of monetary integration worldwide. Among the few Authors who still believed in the effectiveness of active national monetary and fiscal policies, James Tobin proposed the introduction of “sand in the wheels” of international finance, in order to reduce speculative capital flows and enhance national autonomy in economic policy choices. For this reason, the literature has usually contrasted the original proposal of a Tobin Tax to any hypothesis of supra-national economic and monetary integration. Nevertheless, as it was also designed to provide a global public good, namely enhanced financial stability, it may also cooperate with regional integration processes worldwide. The paper aims at reviewing the debate on the Tobin Tax in the literature concerning European and international monetary integration processes and at verifying the past evolution and future perspectives of similar proposals.

Keywords: Tobin Tax, financial integration, crises, capital movements

JEL Classification: B22, E42, F33, G15