Floor Discussion of the Griffith-Jones Paper

The Tobin Tax

Though the Tobin tax proposal was only one of the many recommendations in Stephany Griffith-Jones' paper, it attracted the most attention. Many thought it would not help at all; only a few felt that it had some merit.

Jean-Jacques Rey succinctly formulated the doubts he and other central bankers had about the Tobin tax: "It seems to me that it will work so indiscriminately that it will be difficult to make sure that it actually achieves the purpose for which it is instituted." Griffith-Jones' acknowledgement that technical problems would have be overcome before it could be implemented was "an understatement", he said. "I can think of many ways in which tax payments would quickly evaporate when such a tax would be enforced, and I am sure that André Szász and I can imagine various ways to transact in Benelux to avoid it." Proposals like the Tobin tax, in his view, seemed to be inspired by the idea that if one can't make sure the wheel moves in the right direction, one puts some sand in the wheel. "I am not sure that is really advisable," he noted.

John Williamson observed that though such a tax would probably substantially reduce the day-to-day trading on the money markets, it would hardly affect trading once a speculative drive against a currency had started. "When there is only a one-way option, a 25 basis point option the other way is not going to influence anybody," he explained. Moreover, the Tobin tax would not only penalise the 'bad guys', the speculators, but also the 'good guys'. "If exchange rates have become misaligned, you are taxing the people who want to support the currency just as much as those who are wanting to get out," Williamson said.

Ariel Buira saw another problem with the Tobin tax. He was afraid that it would affect the trading of developing countries. "Since most of the trade operations of LDCs are recorded and paid in foreign currencies, you may unwittingly also be imposing a tax on trade," he said.

Philippe Moutot wondered whether the Tobin tax would not absolve the national authorities from the necessary coordination, while he believed that such coordination might be a much better way to address the problem of speculative currency transactions than the Tobin tax. One should bear in mind that speculation is not only provoked by deficiencies or efficiencies of markets but also by inefficiencies and a lack of coordination of monetary

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authorities, he warned. "We should not overlook the fact that markets are very dependent on expectations of the future, and expectations of the future, in turn, are very dependent not only on the fundamentals of each country but on the coordination between the national authorities as well."

Interestingly enough, central banker Wolfgang Rieke expressed some sympathy for the idea behind the Tobin tax, though he immediately added that he would not support it as long as he had not heard strong arguments in its favour.

"I cannot help being impressed by the enormous number of foreign exchange transactions relative to real foreign transactions in the world. Foreign exchange trading is something that takes place to a large extent unrelated to anything that has to do with real trade. The costs of doing this business have come down enormously: telephone costs are now only a fraction of what they used to be, and so forth. The people who are engaged in this business, the so-called '20-years old', live on turnover. So there will also always be a temptation to create news which then creates turnover. All this could possibly be slowed down somewhat by a tax as proposed by Tobin. But a tax of 1/4 per cent would certainly not be a factor that would hinder these people from going on with their operations," Rieke said.

Peter Kenen stressed that a Tobin tax regime could only work if it were globally comprehensive. "I can just see a BCCI operating out of the Channel Islands and conducting your foreign exchange business for you very profitably and not paying the tax," he said.

John Langmore was one of the few who came down strongly in favour of the Tobin tax. He thought it would be a good instrument for influencing the 'herd instinct' in financial markets. "It will reduce the extreme of overshooting, and that is very valuable," he said. Since many other transactions are taxed in some form or other, the absence of taxing on spot transactions in foreign exchange acts as a strong incentive for speculators to operate in this market rather than in others, Langmore argued. He believed that the costs of the Tobin tax for longer-term investors would be negligible and that such a tax would therefore not interfere with genuine investments.

Better regulation and coordination

Percy Mistry stressed that the issue of the regulation of securities and banking, both domestically and globally, is an area which requires much more attention now, "especially where developing countries are concerned." As an example "of a colossal regulatory failure" he referred to the stock market collapse in India in April 1992, which created a loss of almost fifty billion rupees on the banking system.

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John Williamson, on the other hand, referring to the 1987 stock market collapse in New York, argued that crises in securities markets were not all that bad.

"If one looks back to 1987, to what has been called Black Monday but in my view could better be named Golden Monday, one just sees how wonderfully well the market worked, because the stock market had got itself overvalued and then very quickly corrected itself before it had time to create real damage to the economy. The same thing is true in equity markets. Why should we worry when they go up and down?" Williamson asked provocatively.

Ariel Buira did not think there is a greater risk of instability in securities markets today than there was some years ago. On the question of the possibility that investors might move out suddenly, he suggested distinguishing between three types of flows:

* *direct foreign investment*, in which investors are committed to bring in machinery and cannot move out quickly even if they fear there is going to be an exchange-rate crisis;
* *equities*, where, if investors want to move out a substantial amount of equities, they will depress market prices, and when market prices fall by, let's say 20 per cent, investors will have to think again, because with a 20 or 10 per cent devaluation it is not worth liquidating your stock to move out – "It is only if you are the first one that you can do this, otherwise it will not work," Buira observed;
* *government debt*, such as treasury bills, in which case, if any significant amount is moved out, interest rates will rise, and investors may reconsider whether it would be wise to move out.

Buira also believed that the most important determinants of capital flows are the economic fundamentals of LDCs rather than the so-called push, pull or rejection factors from industrial countries.

Bernard Snoy, though agreeing with Griffith-Jones that in the long run the setting up of a global board of regulators might be an interesting proposition, stated that in the short run "it would be better to rely more on the International Monetary Fund as part of its surveillance mission to see to what extent the supervision of the markets could be enhanced to mitigate some of the possible negative effects of globalisation."

On the other hand, however, Snoy advocated further deregulation, because developing countries are still suffering from distortions in capital markets of industrialised countries. "They still need the dismantling of regulations in several industrial countries which prevent institutional investors, for instance pension funds or insurance companies, to invest as much as would be optimal in the emerging markets," he argued.

Snoy also pointed to two "plagues" Griffith-Jones had not dealt with in her paper: money laundering and tax evasion.

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"The laundering of money related to drugs is one of the greatest problems in Latin America, and precisely because of the progress made in financial technology it is very difficult to eliminate," Snoy said. The same holds true for tax evasion, he argued. "It is obvious that the globalisation and integration of world financial markets is making it much easier to evade taxation. Each country tends to be a tax haven for the residents of the neighbouring countries. It is a very, very difficult problem, which can only be solved in the very long term."

Ifigenia Martínez suggested that one should start thinking about universal taxation. "I would favour, for example, a universal income tax on the rich, and a universal energy tax on non-renewable resources," she said. Such a tax would have to be globally comprehensive, she added, and at this stage of international economic cooperation it was highly unlikely that universal taxation would become reality in the near future.

Martínez favoured the monitoring of international financial flows, among other things, to get a hand on the money laundering related to drugs, "which is very big for some countries and very destabilising too".

A third point Martínez put forward was that today's world recession makes it more important than ever for the financing of development in developing countries to be done as much as possible by mobilising internal resources and by fully utilising the savings capacity of each country. She referred to the United States, "which has a very low savings coefficient", and to her own country, Mexico, "where the top 20 per cent of the families earns about 60 per cent of the disposable income, which means that they have a huge savings capacity to finance the recovery and further development process."

Philippe Moutot observed that coordination is needed not only between supervisors or regulators, but also between market authorities and other authorities such as treasury officials. He also said that though one could advise a Global Board solution, or an IMF solution, it would be equally important to make sure that the information generated by markets was conveyed efficiently and swiftly to the regulators. "This transmission of information seems to me an important point," he said.

Peter Kenen stressed that one should distinguish sharply between securities that are issued and traded on the markets of the developing countries themselves and those which are issued and traded on foreign markets. "Securities that are issued and traded on the domestic markets contribute to the breadth of those markets – the point Mr. Gaspar made earlier – while those that are traded on the international market may contribute to the volatility of the domestic markets," he explained.

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Reply by Griffith-Jones

Stephany Griffith-Jones welcomed the variety of comments on regulation. She did not agree that one should not exaggerate regulation because it would carry a cost.

"I don't take that argument so seriously, because the cost of financial failure can be potentially very large and the regulation costs are minimal compared to such a major crisis. I think the argument to be taken more seriously is that one may lose certain efficiency gains if one over-regulates, because certain transactions which would reduce costs generally or contribute to a better allocation of resources will be avoided."

Griffith-Jones agreed with the gist of the comments made by both Percy Mistry and John Williamson on the instability of stock exchange markets. She disputed, however, Wiliamson's statement that a sudden selling of shares would only result in a drop in the prices of assets. There would also be an impact on the balance of payments, she said. "At a minimum, new investors would stop coming in and there would be an impact there."

Griffith-Jones also agreed with Philippe Moutot's point that there is a need for cooperation between the regulators, the monetary authorities and the market.

"There are a number of market bodies now which undertake quite a lot of self-regulation and they have a certain amount of international coordination. But there is a need to analyse whether the self-regulation – this is a big discussion topic now in the United Kingdom – is appropriate. Of course, self-regulation by market bodies has the advantage that regulators know the market very well because they come from the markets. But it also has the disadvantage that they are too close to the market, not only in the sense that there is a danger of malpractice but also that they don't look at things from the position of the public good."

Griffith-Jones was not surprised by the criticism of the Tobin tax proposal. "Any new form of taxation raises tremendous technical problems and political opposition," she said. However, she did fully agree that the Tobin tax would be only feasible if it were supported around the world. "If not," she said, "the loopholes would create more problems than it would solve." Griffith-Jones also agreed that it would be difficult to discriminate between speculative flows and other flows. "The technical problems are probably very large," she admitted. "But the potential revenues would also be very large," she stressed.

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