1 The International Monetary System: Pluralism and Interdependence

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Robert Triffin is my dear friend and long-time colleague, at Harvard, mainly at Yale, and in Washington. He is a few years my senior, and although that difference seems to diminish with time, I still look up to him as a fount of experience, judgement and wisdom. He tutored me, informally and irregularly to be sure, in international economics and finance. Like all the world, I marvelled at his prescience in the 1950s and 1960s about the gold exchange standard. At my urging, he became a consultant to the Kennedy Council of Economic Advisers, and together we sought to advance the cause of internationalised liquidity in the US government. We did not achieve our goals, but we did nudge developments somewhat in a Triffinesque direction.

The world has changed radically in the last two decades. It seems to me that financial innovation and deregulation have outpaced the worldwide integration of markets for goods and labour, to such an extent that a Triffin-type international monetary system is not yet viable for the advanced capitalist democracies. It may work for cohesive regional groupings of nations; we will probably see in Europe post 1992. I am afraid that for larger groupings, the Group of Three or Seven or the OECD as a whole, we will have to be content for some time with some compromise between national autonomies and monetary integration. I therefore look for arrangements that will preserve national pluralism of policy and institutional structure in our increasingly interdependent world economy.

Since the terminal illness of Bretton Woods in 1971–73, exchange rates among major national currencies have fluctuated violently. Most experts, observers and traders alike, agree that the ups and downs have greatly exceeded variations in rational estimates of fundamental values. The excess volatility reflects short-range speculations, distorting the signals the markets give for trade and long-range investment.
The financial authorities of the economic summit countries evidently subscribe to this diagnosis. Since 1985 they have reduced the volatility of dollar exchange rates. They have reached and announced informal *ad hoc* agreements on desired trading ranges, at the Plaza Hotel in 1985, at the Louvre in 1987, and, after the Louvre agreement fell apart in the October 1987 financial crisis, once again last winter. Their central banks have bought and sold dollars as necessary to keep markets within the agreed target ranges.

Is a more fundamental and formal reconstitution of an international monetary system necessary? desirable? possible? The grass always looks greener on the other side of the fence. The travails of the world economy since 1973 inspire nostalgic longings for Bretton Woods and even for an older and purer gold standard. (The G-7 finance ministers made a gesture in this direction by announcing that a commodity price index they will jointly monitor for early warnings of inflation will give some weight to gold.) Other systemic proposals would keep the floating rate regime while codifying limits on fluctuations and formalising the responsibilities of the several nations to keep exchange rates on track.

Here I shall argue for quite a different proposal, which I first advanced in 1978. An international uniform tax would be levied on spot transactions in foreign exchange (including of course deliveries pursuant to futures contracts and options). The proposal has two major motivations. One purpose is to increase the weight market participants give to long-range fundamentals relative to immediate speculative opportunities. The second is to allow greater autonomy to national monetary policies, by creating a larger wedge between short interest rates in different currencies.

I anticipated superimposing the proposed tax on a regime of market-determined exchange rates with minimal official interventions. However, the tax could also be helpful to systems involving greater interventions, from the present *ad hoc* agreements on target ranges to a restoration of Bretton Woods itself.

The proposal is directed at the major macro-economic powers and their currencies, the Group of Seven for example. Currency transactions within the European Monetary System might be exempt from tax, and similar exemptions might be allowed within other currency areas or for small countries that choose to tie their currencies to a key currency. The International Monetary Fund could be entrusted with administering conditions for exemption.

My proposal is a realistic ‘second best’. I of course understand the