James Tobin was born one hundred years ago

James Tobin was born on March 5th, 1918, in the city of Champaign, Illinois. His name became known to the community of economists when, in 1972, he proposed his special tax system design, more particularly, the Tobin tax. It seems strange, however, that, in fact, this improperly conceived proposal happened to gain him reputation. According to his idea, it would be appropriate to impose tax on speculative international financial transactions, thus making such transactions more expensive by the application of additional costs. The revenue received from creditors should be transferred to indebted, primarily, to poorly developed countries. On the one hand, the proposal was aimed at limiting financial speculation and, on the other hand, at finding alternative financial arrangements for debtor countries.

Economists and economic policy experts agree that this is a novel idea but not considered practically feasible. It is not clear, though, how “good” and “bad” cash flows can be distinguished from one another. In this context, the notion of “short-term” is not suitable for making a distinction between the above financial flows since short-term credit movements may hedge for classical foreign trade transactions or against exchange rate risks. No proper consideration was given to the issue as to how this tax would affect financial markets or to the question whether such tax would divert financial flows away from developing countries. It remained a prevailing view that underdeveloped countries could best be helped by eliminating the import restrictions posed by the developed world.

This idea is typical of Tobin. However, professional circles do not view tax exposure on foreign financial transactions as the mainstream concept constituting part of Tobin’s theoretical work. The revival of the Tobin tax concept in the slogans of opposition politicians is a typical example of how politics can distort economic theories. Decades after its emergence, the concept “was rediscovered” by the enemies of globalization.

It should be noted, however that Tobin was neither an anticapitalist nor an enemy of globalization – he just wanted to improve the efficiency of the financial market. According to him, the free-floating of the exchange rate, which replaced the post-war international financial system, endangers the domestic sovereignty of national central banks since, they would defend themselves against speculative cash flows by exchange rate responses considered unjustifiable from the point of view of individual nations.

The time when Tobin’s ideas were taking shape can be related to the period of World War II, when the images of the Great Depression were still vividly remembered. His mother was a social worker, whose experiences inspired him to improve the world and made him pursue his studies at Harvard University to become an economist and subsequently teach economics at Yale University. In one of his reminiscences he explained all this in more details:

“The economists of my generation were influenced by growing up during the Great Depression and they became economists at the time of the birth of the Keynes’s revolt against old established wisdom. The intellectual excitement coupled with the hope for dramatic social changes proved most attractive to us “. His practical work in the field of economic policy was not insignificant either that, in response to President Kennedy’s invitation to join the Council of Economic Advisers he said “I am just a sort of ivory tower economist”. Yet, he served as an economic expert in the committee drafting Kennedy’s economic policy program in 1961. He gave impetus to the process of the tax-cut policy of the 1960s. But he was not dogmatic, which he proved in a dispute by asserting that instead of having
further tax cuts, an increased spending by the American government would be more desirable. James Tobin was committed to but not uncritical of John Maynard Keynes. This is what made him the main opponent of monetarists led by Milton Friedman.

It is of great importance from the point of view of the history of economic thought that, unlike Keynes’s application of a general theory, Tobin investigated the demand for money and employment in more depth and details. He disaggregated the components of the demand for money and wished to inquire into the reasons behind investors’ decision on selecting particular portfolio elements. James Tobin was awarded the Nobel Memorial Prize in Economic Science in 1981 for his analysis conducted in the aforementioned subject area.

It was not just the field of microeconomics where Tobin created great scientific work. The introduction of the “q” ratio in microeconomics, which is associated with his name, is a measure to evaluate company performance. Tobin applied the letter “q” to indicate the value of a fraction where the numerator is the firm’s market value of common stocks (stock price) and the denominator is the book value of the firm’s total assets. The higher the value of the “q” is, the higher the amount a firm is worth on the market. If “q” exceeds 1, entrepreneurs and investors tend to be optimistic and firms experience an upward trend. In December, 1996 Tobin took the risk of stating that “q”, with its value of 1.5 at the time, had hit historical all-time highs.

James Tobin died on March 11, 2002, in New Haven, Connecticut. We should retain the great scientist in our memories both by translating his works into Hungarian and devoting cover space to publications pertaining to the history of economic thought.