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Currency Transaction Tax – a Concept With a Future

Chances and Limits of Stabilising Financial Markets Through the Tobin Tax



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Chances and Limits of stabilising financial markets through the Tobin tax

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Summary

The concept of the Tobin tax has experienced a resurgence in the discussion on reforming the international financial system. In addition to many legislative initiatives in favour of the Tobin tax in national parliaments, possible ways to introduce a Tobin-style currency transaction tax (CTT) are being scrutinised by United Nations during the preparation of the international conference on „financing for development". The Indian prime minister has recently suggested a tax on currency transactions between developed countries. A study conducted on behalf of the IMF has also favoured a variant of CTT. The German Trade Union Confederation (DGB) and the AFL-CIO in the US have shown their support for this tax as have many other civil society organisations.

While there is increasing interest in the topic with many interesting versions of the tax on the table, the phalanx of opponents is still unbroken. This indicates the massive financial and economic interests which are at stake here.

At least since the Asian financial crisis, there is widespread agreement that short term capital movements are the key cause for exchange rate volatility. Volatility fosters speculative bubbles and can cause or aggravate financial crises. Since developing countries are highly vulnerable to external shocks, they are particularly affected by financial crises. But even without a proper crisis, high volatility contributes to a very unfavourable environment for foreign trade and debt servicing. Short term capital movements must thus be limited. A currency transaction tax serves this purpose. Short term investments often speculate on small profit margins. These very short term speculations are rendered unprofitable by the tax. As a consequence, the amount and the pace of short term transactions are reduced without deterring trade, long term credits, or real investment. This is called the filter function of the tax. Tobin described this as throwing sands in the wheels without damaging the functionality of the wheels. In short, a currency transaction tax makes economic sense and is particularly attractive from a development point of view.

Of course, the Tobin tax can deter neither massive speculative attacks nor all kinds of financial crises. To this end, other instruments are needed. The Tobin tax is only one instrument in a set of different measures for regulating financial markets.

The technical implementation of the Tobin tax is facilitated by the increasing formalisation and computerisation of international payment systems. The tax could be levied at the national or the international level. The revenue from a currency transaction tax is estimated to exceed several ten billion US-$ per year. Civil society groups advocating the Tobin tax focus their suggestions for the revenue's expenditure on sustainable development projects.

There are several measures available for limiting the scope of potential tax evasion. These include political pressure on offshore tax havens to co-operate with the international supervisory or regulatory institutions and differential tax levels for transactions into or from non-co-operating regions. Tax evasion need not be more of a problem for the Tobin tax than for any other tax and can thus not be used as an argument against the tax

The most important obstacle to the implementation of the Tobin tax is the obstinate resistance of those who take advantage from the volatile financial system, i.e. private financial market players and individual national governments, in particular the US administration.

1 A Classical Idea Revived

Nobel laureate James Tobin[1] proposed in 1972 a tax on international currency transactions in order to stabilise exchange rates and to hinder short term speculation. The basic idea behind this so called Tobin tax is simple: a small tax is levied on every currency transaction, i.e. both on buying and selling a foreign currency. Tobin had a tax rate around 1% in mind. This measure renders all currency transactions that speculate on minor exchange rate changes unprofitable, in particular very short run currency investments. These ultra short run speculations would hence be deterred.

But even in expert circles, Tobin's concept received no attention before the 90's. Eventually, the idea was taken up by members of the UN-development programme. In a time of declining official development assistance, the UNDP was looking for new sources for financing development. The core interest was hence not in the tax's regulative function for financial markets, but in its ability to raise revenue.

After the 1994 Peso Crisis in Mexico, the crashes in Asia, Russia and Brazil, and the crisis of the Hedge fund LTCM which could only be saved from bankruptcy by an unprecedented intervention by the US authorities, the dangers brought about by high volatility and instability of liberalised financial markets are visible to the public. In reaction, international organisations like G7, IMF, BIS, and UNCTAD have started a discussion on a "new financial architecture".

The G7 set up a special commission for working out proposals for a reform of the international financial system. This Forum for the Stability of Financial Markets (FSF) has 40 members from 25 countries, from international financial institutions, from central banks, and from supervisory boards. The FSF presented its first report in April 2000. This report has implicitly made several quite critical remarks on financial mainstream thinking. Inter alia, we can read, that it was not only internal reasons like crony capitalism or weak supervisory authorities that caused the Asian crisis, but this crisis is now seen as an expression of systemic risk inherent in the current international financial markets (FSF 2000:1).

The current revival of Tobin's idea to tax international currency transactions has to be seen against this background. His concept has been modified in the intravening years. It has been adopted to the situation on the current international financial markets.[2] At the same time, the support for a currency transaction tax is rising steadily and from different directions:

- The parliaments of France, Belgium, Canada, and the US have witnessed parliamentary questions and draft bills that ask for the introduction of a CTT or for an inquiry into its applicability.
- The Green Party in Germany called for a CTT in an legislative initiative in 1997 which was voted down by the then conservative majority. Since the Greens took power (jointly with the Social Democrats) in 1998, the German Socialist Party PDS introduced a similar initiative, similarly turned down now by another majority.[3]
- In the European Parliament, a draft bill for a CTT missed a majority by only four votes.
- An international appeal for parliamentarians in favour of the installation of Tobin type tax has been signed by more than 500 parliamentarians within one year.
- Indian Prime Minister Vajpayee has suggested the imposition of an international levy on capital flows between developed countries and all capital repatriations from developing countries. The money, he says, could then be credited to a Global Poverty Alleviation Fond.
- The Finnish Government favours in its coalition agreement the taxation of currency transactions, too.
- United Nations have set up a working group that, inter alia, shall inquire the potential and feasibility of a CTT.[4]
- A paper by the UN ECOSOC also supports such a tax (Clunies-Ross 2000:7).
- In the preparation process for the international UN conference on Financing for Development, which will take place in March 2002, this tax is one of the eagerly discussed topics.
- A study conducted on behalf of the IMF regards a variant of the Tobin tax (the so-called cross border capital tax) as a reasonable contribution for stabilising the international financial system (Zee 2000).
- George Soros, owner of the Quantum Fund (worth some billion US-$) and one of the most prominent international speculators, pronounced support for the tax on the basis of his insider knowledge.[5]
- In 1998 the World Council of Churches plead already for a taxation of currency transactions.

In civil society contributions to the discussion of how to reform the international financial system, the call for a currency transaction tax takes

[1] Tobin received the Nobel prize 1981 for his analysis of financial markets and their relations to investment decisions, employment, production, and prices.

[2] The modifications focus on the tax rate. 1% is regarded as to high a rate which would lead to a very drastic reduction of liquidity.

[3] PDS initiative fom 23 April 1999, BT Drucksache 14/840.

[4] This panel is lead by the former Mexican president Zedillo. Other members include

[5] He called for the tax recently again in a TV discussion during the WEF in Davos 2001.

a prominent position. Here the CTT is often denoted as 'speculation tax'. The driving force of the movement for regulating financial markets in order to achieve a socially equitable and an ecologically sustainable development is ATTAC, an organisation founded 1998 in France (Association pour une Taxation des Transactions financières pour l'Aide aus Citoyens). Many groups and associations in Europe, Northern America, and in developing countries have joined ATTAC's activities so far.

A recent example of the increasing support for the Tobin tax coming from different organisations can be seen in the joint declaration of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and the Federation of German Trade Unions (DGB). This declaration calls for stable exchange rates between the Euro, Yen, and Dollar, for capital controls, and the taxation of currency transactions.[6]

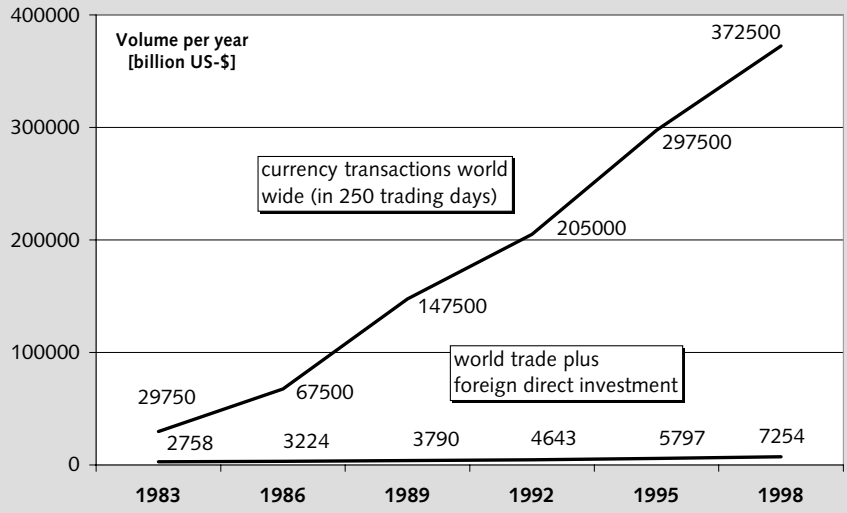
In face of increasing support of the Tobin tax and its variants, the phalanx of opponents is still unbroken. Robert Mundell, Nobel Laureate in economics in 1999, called the Tobin tax an "idiotic idea" (*Libéracion* July 3, 2000). The economics mainstream, both in politics and in academia, regards the tax as harmful, ineffective, or unfeasible. During the above mentioned preparation for the UN Finance for Development Conference, the US managed to make the Tobin tax a taboo word. The US delegates demanded that the term does not appear in any official document. Similarly as a result of US pressure, publications by staff members of the UNDP in which the tax was mentioned favourably had to be declared as private statements by the authors, e.g. the extensive study of the Tobin tax by Ul Hay *et al.* (1996).

The German Ministry of Finance has given a balanced statement to the German parliament's commission of enquiry (*Enquête-Kommission*) on 'globalisation'. Although the paper concluded that "the economic disadvantages [of the tax, P.W.] would not be compensated by the supposed advantages", the paper concedes implicitly that exchange rate volatility is a big problem. Referring to the Euro system which prevents any exchange rate changes in the Euro area, the paper suggests that "a fix exchange rate system or, respectively, a common currency renders the introduction of the Tobin tax superfluous" (BMF 2000:12).

The obstinate resistance against the tax signals the massive economic interests which are at stake. In fact, the introduction of the Tobin tax will take away profit opportunities of several billion US-$ from certain speculators (cf. Section 9 below).

● FIGURE I

Detachment of currency markets from trade and investment



Source: BIZ (1998); WTO, international trade statistics

2 The Problem: Short term Capital Flows Cause Stability Risk

Since the financial sector has been highly deregulated after the dissolving the Bretton-Woods currency system in the 70s, world-wide currency turn-overs have risen from 70 billion in 1970 to 1.5 trillion US-$ per day today. That is an increase of more than 2,000 percent. According to the Bank for International Settlement (BIS), more than 80% of these 1.5 trillion are so-called round trip financial flows with a maturity of seven days or less, (cf. BIS annual report 1998). Thus, these 80% cannot have any foundation in real economic activities like or trading, investment in real capital, but they are completely detached from real economics.

This 80% of the daily currency turn-over (1.2 trillion US-$) is profit gained from minute rates differentials, often even below the threshold of 0.1 percent.[7] The enormous sums make these activities profitable. Consider the following example: a bank buys assets for 100 billion Euro and sells them within one day at a profit margin of only 0.1%. Still, this amounts to a net profit of 100,000 Euro which is made hands down.

In contrast, in 1998 the volume of world-wide foreign trade was only worth 6.9 trillion US-$ and all foreign direct investments 619 billions (Worldbank 2000). Taken to-

[6] DGB press release PM 025, Jan 30, 2001 (www.dgb.de)

[7] The basic unit is the basis point in this context. 100 basis points are 1 percent.

gether, this is about 2% of the annual currency turn-over. Of course some of the short term transactions are closely interlinked with real economic activity, like hedging trade and investment against exchange rate risk, and some are part of a short term (rollover) financing strategy of long term investment. Still, even when taking these deductions into account, there remains a significant excess liquidity which is mainly driven by speculation.[8] Liquidity is not a problem per se. Quite to the contrary, it is necessary for the frictionless functioning of trade, real investment, and international credit relationship. By contrast, *excess liquidity* denotes the supply of liquidity which exceeds the amount needed for these real economic transactions. On today's financial markets, this is the bulk of currency transactions.

Excess liquidity causes two intertwined problems: (a) it increases exchange rate volatility, and (b) it is a destabilising factor in itself by its sheer volume and by the speed at which it travels around the world.

The detachment of the financial flows from any basis in the real economy has led to a self-referential system. Rates and prices are no longer driven by expectations based on economic fundamentals, but only on short-term profit expectations of private actors like banks, insurers, and funds. Their transactions result in unanticipated reactions of exchange rates. This, in turn, leads to a renewed investment incentive for traders, which try to exploit these exchange rate movements – generated by their like - for more profit.

Due to the principle of supply and demand, excess liquidity renders short term credits relatively cheaper than long term credits. Even actually long term capital demands are then financed by rolling over short term credits. The drawback of this development is an increased stability risk, because short term credits can be withdrawn in the short run, too. This can have a knock-on effect, like the one which brought the LTCM Fond close to collapse.

These factors together generate a feed back mechanism. Volatility creates its own causes again and again. When market participants extrapolate short term market fluctuations, they are reinforcing the exchange rate's biasedness and volatility. Short term expectations feed long term beliefs.[9] Daily speculation can thus cause the building up of a speculative bubble which will eventually bust, resulting in a crisis (Arestis/Sawyer 1997: 753).

While mainstream neoliberal thinking focuses on efficient capital allocation and neglects problems related to short run excess liquidity, there are some recent heterodox studies emphasising these problems (cf. de Brunhoff/Jetin 2000, Frenkel/Menkhoff 2000). In fact, short term investment leads to short term thinking. This acceleration of behaviour and thinking implies increased asymmetry of information and results in rationally no longer justifiable investment behaviour. An example of such irrational market behaviour may be seen in so-called noise trading, which relies on irrelevant data (Chart analysis) or extreme risk taking (cf. Frenkel/Menkhoff 2000:6). Myopic and irrational behaviour leads to inefficient capital allocation. "Abrupt portfolio adjustments can involve sudden cessation or reversals of flows and sharp changes in asset prices" (FSF 2000:1). This corresponds to herding behaviour on behalf of the investor, which is exacerbated by computer based trading systems.[10] This refutes the standard argument in favour of short term contracts, namely its supposed contribution to efficient capital allocation.

Another negative consequence of market acceleration and short-termism relates to supervision and intervention. For supervisory agencies and central banks, the time in which they can detect a crisis and react to it (e.g. by buying a currency under pressure), is also extremely reduced (cf. BIS 1999: 8-11,165-6). In combination with the enormous sums which private speculators can make available in virtually no time, there is not much scope left for central bank intervention when facing a crisis or a speculative attack, even for medium sized national economies.

To sum up: excess liquidity of short term capital flows leads to

a) instability of the environment for trade and real investment. Exchange rate volatility makes firm level planning more difficult and costly, since it necessitates measures and instruments to hedge the risk. Conversely, stable exchange rate regimes generate an environment conducive to foreign trade, investment, and sound international credit relations. Developing countries with their very vulnerable economies are in particular need of predictable exchange rate environments, but this applies for more developed countries, too.[11] Developing countries, which are often highly indebted, would also benefit from stable exchange

[8] Exact figures on the composition of short term financial flows do not exist. Due to strict banking and business confidentiality, only national supervisory boards would have a chance to get estimates from random samples. But their very limited ability (and willingness) to control private financial actors is a fact a sad as well-known.

[9] No serious observer will attribute the Euros fall against the Dollar by one third within one year to a deterioration of the European economy relative to the US by the same degree. By contrast, the Japanese Yen has kept up with the Dollar in spite of the Japanese economy being in a recession for almost a decade now.

[10] Herding behaviour denotes the tendency of investors to imitate one another's decision, which leads to (irrational) waves of similar behaviour. In practice, some handful of fond managers are the leaders of the pack. Computerised trading induces more herding, since trading programmes are almost identical and lead to an automatic – hence simultaneous – selling (buying) of a currency or asset when its price passes a certain threshold.

[11] Basically, all arguments which have been raised in favour of introducing the Euro apply here, too. A common currency is nothing but the final end to exchange rate fluctuations. This is why e.g. Japanese investors in the U.K. demand Britain to join the Euro system.

rates because such make debt repayment more predictable.

b) Excess liquidity fosters speculative bubbles which lead inevitably to a crash.
c) Excess liquidity increases the vulnerability by other factors, including political ones, too. Any reason for jeopardising investors' confidence in a country can lead to an instantaneous withdrawal of short term funds.

Crashes and crises, the inevitable companion of financial instability, could be accepted as a periodically occurring market clearing mechanism if only those were affected which lost their money through speculation. But although the speculative business of banks and funds has been detached from the real economy, financial crises have not lost at all their detrimental impact on the real economy and on society's development. The crises in Mexico, in Southeast Asia, and in Brazil have impoverished millions of people who have never engaged in a single financial market transaction. Even those developing countries that do not have a proper financial market themselves have had to suffer from the contagious effects of financial crises in neighbouring countries (Worldbank 1999).

Even the FSF recognises "risks and potential costs, especially in the case of short-term flows" and favours a reduction of volatility (FSF 2000:1). Its report notes that "the risk of crisis seems to have been increased by factors that, intentionally or inadvertently, bias the pattern of capital flows toward concentrations of shorter-term maturities, which entail roll-over risk and thus can be more easily reversed". "Such potential biases should be identified, and prompt consideration should be given to their elimination in light of the added volatility they might cause" (FSF 2000:1). In order to stabilise the international financial system, short term capital movement without foundation in real economic activity (so-called hot money) has to be avoided. At this point, the proposal of a currency transaction tax comes in.

3 The Economic Rationale behind a CTT

The bulk of currency transactions serves the purpose of exploiting minute short term differences in exchange rates. These are often in the order of magnitude of 1/10,000 % only. With enough money at hand, these differences readily make considerable profits. Even a very small tax on this kind of transactions would make these unprofitable. They would thus decrease rapidly. The degree of this decrease depends on the tax rate and on market participants' reactions (demand elasticity). Felix and Sau estimated the decline at a tax rate of 0.25% to be less than 33% (Felix/Sau 1996:243).

Basically, the tax would work as follows:

- the tax will be levied on any currency transaction, both on the spot and on the forward market.
- Liable to the tax will be all financial market actors with the exception of central banks, governments, and international governmental organisations.
- Transactions' nominal value will be the tax base.
- The tax should at least include the three leading currencies US-Dollar, Yen and Euro.[12]
- The tax has to be paid both when selling and when buying a currency, such that a round trip to another currency (buying and selling it within one period) would be taxed by 1% if the tax rate was 0.5% per transaction.

Regarding the tax rate, there are several proposals in the discussion. The have been converging to the spectrum of 5 to 50 basis points. The idea that a small rate like this would be sufficient for redirecting financial flows, is more and more widely accepted, while Tobin's original suggestion of a 1% tax rate might squeeze to much liquidity out of the market. Getting the tax rate right is a difficult task, though. The answer to this question has to be based on complicated and expensive econometric studies about the effects of different tax rates. In the political debate on reforming the international financial system, governments should be required to contribute the necessary resources to these studies. Still, any predictions of this kind are bound to be uncertain to some degree. This element of uncertainty is inherent in international financial markets. In consequence, any introduction of a CTT should start cautiously with a low tax rate, which can later be increased if the desired redirection effect is not strong enough.

3.1 The Filter Effect of a CTT

Taxation will make all currency transactions more costly, whether they serve a real investment with a maturity of 10 years or an intra-day speculation. The whole point of a CTT is the fact, that it would have very different effects on the profitability of these two deals. Financing a long term real trade will become somewhat more expensive, but will remain quite profitable. This may be counterbalanced by fewer expenses on hedging instruments once market volatility comes down. The longer the investment horizon, the smaller the effect of the CTT will be. This is called the *degressive structure* of the tax. Currency transactions that have a base in real economic activity will not be hindered by the tax.

Quite the opposite applies for short term speculation and arbitrage.[13] While the once only deduc-

[12] The feasiblity of introducing the Tobin tax without the U.S. is discussed in Section 8.

[13] The fact that a CTT would also prevent arbitrage if its profitability is below the tax rate need not be a disadvantage at all. Arbitrage leads only to short term equalisation of market conditions and is a main contribution to high volatility. Even without arbitrage in the short run, there will be a currency price equi-

● TABLE I

Degression of the CTT at different tax rates

maturity	CTT degression (in %) at a tax rate of		
	0.25 %	0,5 %	1 %
1 day	182,5	365	730
1 week	26	52	104
1 month	6	12	24
3 months	2	4	8
6 months	1	2	4
1 year	0,5	1	2
2 years	0,25	0,5	1
10 years	0,05	0,1	0,2

Source: Huffschmid (1995)

tion of a few basis points has a negligible effect on long term real investment, its effect on short term deals will be prohibitive. Only if the profit margin is above the amount paid in tax, a transaction is again profitable. Table 1 shows the break-even points for different tax rates and maturities. Accordingly, a repeated weekly investment at a CTT rate of 0.5% needs a profit margin of at least 52% (per year) in order to yield a positive balance sheet.

In other words, a CTT functions like a filter. Undesired hot money is held back, but liquidity needed for real economic activity can pass through. Excess liquidity is cut back and capital movements are decelerated without removing liquidity as such or halting all transactions. Tobin described this by the image of throwing sand in the wheels without bringing the wheels to a halt.

The tax achieves via the degression mechanism a differentiation between real investment and speculative transactions. Without such a mechanism, it would be very tricky to distinguish real investment from speculation, necessary for fostering the former and reducing the latter. Developing countries in particular are in urgent need of more stable and long term investment.

librium across market places.

3.2 The stabilising effect of a CTT

The degression leads to a spontaneous adjustment of currency contract maturities. In this way, a CTT stabilises financial markets in general and small or developing economies in particular, because:

- the destabilising excess liquidity on the financial markets will be cut back by stopping everyday speculation and its volatility enhancing effect without questioning volatility as such. Even after a cut in current currency transactions by 50%, there would be more liquidity in the markets than in the 80s. Traders and investors would still find enough opportunities for hedging their activities against risk;
- with a decline in short term transactions the incentive to speculate on short term exchange rate movements vanishes, too. This would also prevent speculative bubbles which can today build up from accumulating short run expectations. The tax has thus also a prophylactic effect with respect to crises. (Some authors consider this to be the main contribution of the tax, cf. Arestis/Sawyer 1997:760).
- especially developing countries will benefit from the reduced threat of a crisis, since these economies are particularly vulnerable to shocks and financial crises;
- the price increase for short term transactions will also affect short term loans and hence reverse the trend of favouring short term credit relationships. This will reduce the systemic risk which is involved in short term lending. This would again favour developing countries with their high vulnerability to economic shocks;
- from a development point of view, the general increase in stability is very valuable. Both foreign trade and credit relations would become more predictable. Moreover, developing countries will also profit from the resulting rise in foreign direct investment;[14]
- central banks could, albeit to a limited degree, reacquire monetary policy as a macroeconomic instrument without being threatened by an instantaneous capital withdrawal. Interest rate cuts in order to boost investment and consumption could again be implemented autonomously at a national level, although within certain limits and for a fixed period of time only.[15]

3.3 No panacea

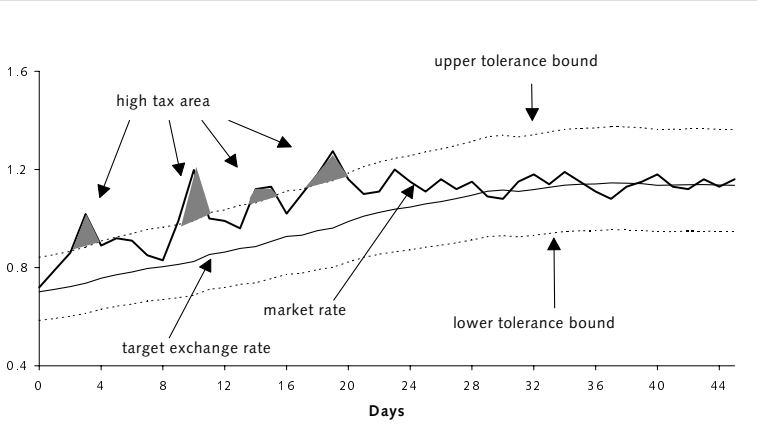
Although the Tobin tax has many advantages, it should not be regarded as a universal remedy for all the ills of the international financial system. Its proponents have always been unambiguous on this point. Some of the critics have called it a tax for good times only, an instrument which is of little value with respect to the most serious speculative attacks and crises. This is very

[14] It is beyond the scope of this paper to discuss whether and when foreign direct investment contributes to sustainable development.

[15] Note that the monetary autonomy is limited to the medium run, since at a CTT rate of 0.25% and a difference in long term interest rates of 2%, already 3-month bonds become profitable again. Moreover, changing the interest rate involves the risk of engendering new speculative capital movements (cf. Kulessa 1996: 95).

● FIGURE 2

A high second tier tax on exchange rates outside a currency band could discourage speculation



Source: Paul Bernd Spahn (1996: 26)

true: the tax is designed for times of business as usual on the financial markets. It is not suited to remedy, for instance, massive speculative attacks where the flock of investors is lured by short term profit expectations of 10 or 20 percent. During the Asian crisis, these figures were even higher: 40% (Thailand) to 60% (Indonesia). A financial or currency crisis can have many causes, and sometimes there is even a set of different causes at work. Speculation need not always be among these. The Peso crisis in Mexico 1994 was brought about by a peculiar security concept on behalf of the US pension funds. They withdrew their money simultaneously in almost classical herding manner and triggered the crisis. The financial crisis in Russia was caused primarily by the ailing national financial system and by an unsustainable budget deficit. In both cases, a CTT would have been of little help. The tax shares its limited range with any other financial instrument. The proposals for improved information, transparency, and banking supervision, which the Financial Stability Forum has developed and which enjoy widespread support by mainstream economists, will be even less capable of preventing serious crises.

In a real crisis, one must resort to drastic measures like capital controls and closure of banks and exchanges.[16] Still better would be a preventive blocking of speculative bubbles. Paul Bernd Spahn, Professor at Frankfurt University, suggested an interesting instrument along these lines (Spahn 1996). He proposed the introduction of a second tax in addition to the Tobin tax as part of a two-tier system. Inspired by the exchange rate system which was in place in the EC 1979-95, Spahn advocates an exchange rate target-zone within which transactions are taxed by a small Tobin tax rate of 0.02%. On all transactions outside the target-zone, a prohibitively high tax rate of 50% to 100% would be levied. The target-zone will be announced daily by the central bank, which derives the bounds from the 20 day history of the exchange rate.

Spahn's proposal has not only the advantage of preventing speculative attacks, but also of being implementable by a single country on its own.

A CTT is one instrument among several for regulating financial markets. A clever combination of different instruments is needed, the optimal one depending on time and circumstances. As implied by the term 'new financial architecture', not a single critical measure, but a comprehensive set of reforms is required. To put it in a nutshell, what is urgently needed is a renewed Bretton Woods, adapted to the conditions of a globalised world economy and the challenges it faces in the 21st century. Building blocks for this project have been produced by civil society groups, too (KAIROS/WEED 2000).

[16] India and China were the only bigger countries where capital controls had been in place before the Asian crisis. As a consequence, they were hardly affected by the crisis. Malaysia managed to limit its exposure to the crisis by introducing comprehensive capital controls and a fixed exchange rate regime immediately (cf. IMF 2000).

4 The Technical Feasibility of a CTT

A criticism often raised against a CTT is its alleged unfeasibility: the tax is said to require a vast administration, to drive transaction costs beyond limits, or to be technically simply unfeasible.[17] As a matter of fact, there is already an established infrastructure – established for other purposes, though – which can be readily used without much effort for collecting the tax, both nationally and internationally.

The bulk of currency transactions takes place at the interbank level. In response to the explosive growth of currency transactions, to new communication technologies, and to the increased risk involved in international financial business, a technical and regulative infrastructure has been set up for several years now. [18] The Bank for International Settlement (BIS) is supervising this infrastructure.

The German central banks uses the payment system "Target" for its Euro-transactions, while the fed is using a system called "Fedwire". In

[17] For a comprehensive discussion of technical questions related to the implementation of the Tobin tax, cf. Schmidt (1999).

[18] This includes the *Lamfalussy Minimum Standards*. Under these standards, the *Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries*, a working group of the BIS, grants other central banks the right of excluding banks from payment transactions when they breach the rules.

London, all transactions in British Pounds are recorded in "CHAPS" (for clearing house automated payment system). In short, almost all currency transactions are already being recorded under a nationally regulated system. With little programming effort, a CTT could be implemented using these systems.

Registering these transactions is fairly simple: whenever a transaction is conducted within a national payment system, the computer system charges the amount against one bank while the other bank – where the money was paid in – receives a credit note. A transaction within one currency thus results in two corresponding payment acts inside one payment system. For a transaction from one currency to another, each national payment system registers only one of these payment acts, e.g. one bank receives a credit note in Euro, which is registered in Target, and the other bank is charged the amount in US-$, which is recorded in Fedwire then. Both parts of the transactions (as recorded in Target and in Fedwire) would be taxed.

Already today, the S.W.I.F.T.-system could be used for levying a CTT. S.W.I.F.T. stands for Society for World-wide Interbank Financial Communication. This system is run by a private organisation in Brussels, which has connected about 1,800 banks in more than 80 countries in its computerised network for foreign payments so far. S.W.I.F.T. today already offers trading in securities and derivatives. Derivative trading (including contracts of differences) would be taxed on the basis of the full contract volume, and not only on the difference between buying and selling price, although only this difference is actually transferred.

This implies that for the implementation of a CTT no new infrastructure has to be erected. Thus, both the costs of levying the tax and the additional technical and administrative expenditure will be negligible, especially when compared to the macroeconomic benefits reaped from the tax. Technically, levying a CTT is not more complicated than automatic debiting Jon Doe's current account for his banking fees.

Moreover, there are proposals of setting up an international bank, the 'continuous linked settlement bank', which would supervise, 24 hours a day and in close co-operation with national payment systems, all international interbank settlements (Schmidt 1999:5).

5 The Tax Revenue

When James Tobin circulated his proposal, he was primarily concerned with stabilising the financial system. Revenue and its use were less relevant to him. If one is interested in raising new funds in the first place, this will lead quite a different approach. Then there are alternatives to the CTT, too. Several suggestions are discussed in the preparation process for the UN conference on 'financing for development' (cf. Annan 2001). These include international taxes on aviation fuel (with its ecologically desirable effects on air traffic), a tax on luxury goods, or taxing global public goods like international waters, international airspace, or electromagnetic frequencies.

On the other hand, a tax will inevitably lead to a revenue. Thus, questions of the amount the tax will raise and of its expenditure have to be addressed. In addition, far from being a necessary evil, the revenue offers the chance of achieving two goals with one instrument: regulation and providing new funds. This aspect of the tax makes it also easier to gather political support for the proposal.

Sooner or later, international taxes will take a prominent place on the political agenda anyway, as a consequence of the problems raised by the continuing process of globalisation. While more and more firms and financial market actors beyond the scope of national supervisory institutions – and hence beyond the reach of national tax authorities – the national tax base is dwindling. At the same time, the global players' economic activity entails new costs – economic, social, and ecological in nature – which are show up neither in the firms' nor in the national accounting. International taxes are thus a logical and necessary consequence of globalisation, if national governments are to re-acquire ability to act, including power over their tax base. In this respect, the discussion of a CTT leads naturally to a more general debate of international taxes.

Prospective tax revenues from a CTT can only be vaguely estimated. Since it is the proclaimed goal of the tax to diminish its own tax base, the revenue will decline over time. But it will never converge to zero, since it is not the aim of the tax to stop all currency transactions, but only to take away excess liquidity.[19]

Researchers at the UNDP have estimated the CTT revenue for different tax rates (0.05%, 0.1%, and 0.25%) using econometric techniques. This study has taken into account both the expected decline in currency transactions due to the tax and an estimated 25% deduction for transactions which will evade or avoid the tax. Even at the lowest tax rate of 0.05%, the tax revenue would be more than twice as large as all current official development assistance by all industrialised countries taken together (cf. Table 2).

6 How Should the Revenue Be Used?

In general, there are three possible ways in which the revenue could be used:

- national expenditure in the country of the revenue's origin,
- international expenditure
- a mixture of national and international expenditure.

[19] Hence the criticism raised by the German Ministry of Finance, that the tax would "ideally" eliminate all short term currency transactions, has no foundation in reality (cf. BMF 2000:7).

■ TABLE 2

CTT revenue at different tax rates

tax rate	expected revenue (billion US-$ per year)
0,05%	90,1
0,1%	148,2
0,25%	302,1

Source: Inge Kaul/John Langmore and David/Sau in: Mahbub ul Haq et.al. (1996)

Tobin favoured an international use of the tax revenue. Similarly, it has been demanded on the part of civil society to collect the revenue in an international fund for development, ecology and social equity. The UNDP pleads for an expenditure on developmental aims, too. Finally, as the Tobin tax is discussed in the preparation for the UN conference on financing for development, of course this discussion will focus on raising funds for financing for development.

The Indian Prime Minister suggested directing the tax revenue into a global fund to fight poverty. From the perspective of fostering global sustainable development, an international expenditure for ecological, social, and developmental purposes would indeed be optimal. One could even dispense with setting up new organisations to this end. The money should be distributed under the roof of the UN and spent on ecological and developmental projects.

On the other hand, political opposition against any new taxes, and in particular against international taxes, seems still almost insurmountable. If the revenue was – at least partially – used for national purposes, it would be easier to gather more support for the tax on the part of national governments. An international use, though, would help to get the support from developing countries. Hence, a mixture of national and international expenditure might be optimal from a strategic point of view. Part of the revenue could remain in the countries where the money comes from while the rest could be jointly used by the international community.

One could also think of a split solution where e.g. developing countries would be allowed to keep the revenue raised in their countries (and spend it for poverty reduction), while the rich countries had to share the revenue. One should keep in mind that even when the revenue was used for national expenditure only, the tax would not lose its regulating function for financial markets. The political struggle would then focus on the national budget. Here, the rich countries could still be pushed by their own citizens to spend the money on bi- or multilateral development and environmental programmes.

Anyway, disagreement over optimal expenditure of the tax revenue is not the main obstacle for the implementation of a CTT. Once the decision to implement a CTT is taken, the different interests in the pie could be more easily evened out since all will get their share. Although this evening out might still involve a tough political struggle, no argument against the tax can be constructed from this. One should not focus to much attention on this question, because first the tax has to be accomplished before the expenditure has a chance to become a problem at all.

7 Tax Evasion And Avoidance

Opponents of a CTT often point out that the tax could easily be evaded. Currency transactions could be conducted in offshore centres and profits re-transferred to the industrial countries under a false label.[20] Constructions could be established for conducting transactions outside the scope of any payment systems. Even emerging black markets for currency have been conjured up (BMF 2000:10).

There is a kernel of truth in these stories. Private financial market actors have been very inventive when it came to circumventing legal rules in order to increase their profits. In many cases, they have not shied away from outright criminal methods, as has been shown repeatedly by successful investigations against large scale tax evasion. Even renowned business banks have been involved in such illegal activities.

Nevertheless, the fact that some might evade the tax is neither an argument against the CTT nor against any tax. Any tax can be evaded and will be evaded. This holds not only for easily evadable taxes like wealth or capital income taxes. Even income taxes that are directly deducted from the wage can be evaded, e.g. by moonlighting or pseudo self-employment.[21] Yet, nobody has demanded the abolishment of these taxes.

In addition, transactions in order to circumvent an international CTT are complicated and costly. To redirect financial flows via offshore centres requires a costly infrastructure with expensive staff. It would also imply a break up of existing business relations. Relative to the CTT rate, these evasion costs will be inhibitively high. This is the reason why there was no decline in trade volume in derivatives after the introduction of a local tax in London, the so-called stamp duty (cf. Griffith-Jones 1996:155). Note that this stamp duty is anything but

[20] Both the French, the German, and the British Minister of Finance used this argument recently to justify non-supporting the Tobin tax (cf. BMF 2000:10).

[21] Pseudo self-employment has been lively debated in Germany. It refers to the kind of employment where someone is legally self-employed, but economically dependent from a single client (the actual employer). By this construction, contributions to the social security system, which are bound to the employment contract, are avoided.

negligible – it raised a revenue of 1.3 billion US-$ in 1993. Also at other derivative exchanges which levy or have levied a sales tax (like Frankfurt, Singapore, Hongkong), there was no significant competitive disadvantage.

For illegal forms of tax evasion, international investigations of suspected tax evasion should be adapted legally and technically to the new situation together with the introduction of a CTT.

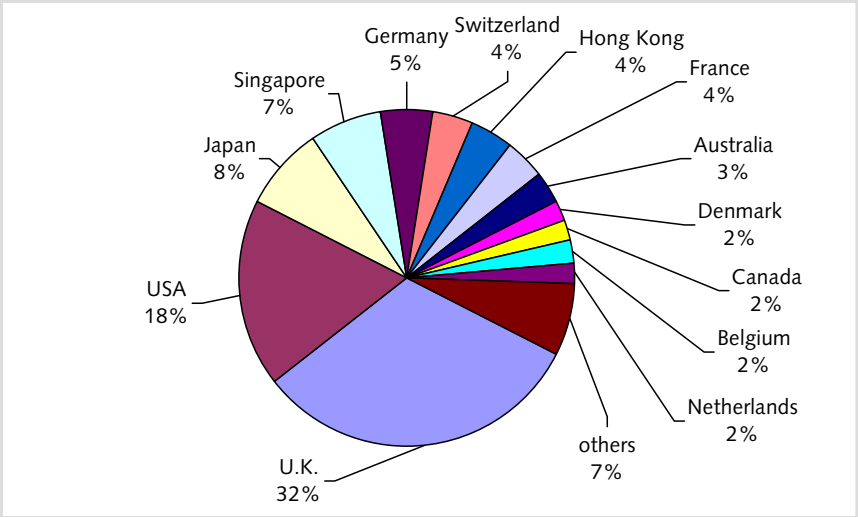
To use offshore centres as loopholes will become increasingly difficult in the future, at least if one is to believe the official announcements of the G 7. The FSF has already identified offshore centres without or with weak supervisory regimes as a risk to the stability of the international financial system. The publication of the FSF report alone has prompted reactions in some centres. Although these reactions might amount to little more than cosmetic operations, this is a signal of increasing pressure on offshore paradises. Both a report by OECD and an investigation by the French parliament arrive at the same conclusion, that offshore centres should be subject to financial supervision and made more transparent (OECD 1999, Assemblé Nationale 2000). Already such simple measures like the publication of a list with the black sheep among the offshore centres will make a retreat to these centres much more difficult for reputable financial market actors.

If the G 7 regard the FSF report as only a rhetoric exercise – and there are clear signs that the reform enthusiasm is ebbing away already – civil society action is called for. Campaigns addressing the offshore activities of national banks and funds will have a considerable impact since these actors are very concerned about their reputation for respectability. As offshore centres are also used for laundering revenues from the drug business, from organised crime, and from terrorism, public attention for these campaigns will be easily obtained.

Finally, if national governments were really concerned about offshore centre activity, they could almost instantly clamp down on these activities by a fee on transactions involving these areas.

● FIGURE 3

Major FOREX markets
(share of total currency turn-over)



Source: Harlem Desir, Glynn Ford (2000)

8 Introducing A CTT Only Regionally

Like Tobin, many proponents regard the simultaneous introduction of a CTT in at least the major financial market places as essential. These places in the US, in Japan, and in the EC account for 90% of all currency transactions. From the academic circles supporting ATTAC in France, there has been a new proposal to introduce a two tier system which would not need the support of all major countries. The proposal is similar to the one by Spahn (cf. Section 3.3).

The two tier system would only need the support by a critical mass of participating countries. These would levy a small CTT rate, say 0.05 %, on all transactions among their own country group. A second tax rate would apply for transactions across the common border of the group. This differential system will put pressure on the non-participating countries to join to the CTT if they need the transactions to the CTT group.

Since 70 % of all currency transactions take place within the EU and the Yen-area, this would be sufficient for a "critical mass" even without the US (cf. Figure 3). This means that the introduction of a CTT and a first step to decelerate financial flows could be achieved without the most stubborn opponent. The financial markets in the US are so closely interlinked with the EU and Asia that a penalty tariff in form of a high CTT rate would impose a heavy burden on US investors. The decisive question is whether the EU is prepared to engage in the entailing political conflict with the US.

9 Main Problem: Political Feasibility

There can be no doubt that a CTT makes good economic sense. Especially developing countries will benefit from an increased stability of the world financial system. The implementation of a CTT does not pose major technical or administrative difficulties. Public support for the tax has been rapidly increasing recently. The main obstacle is the stubborn political opposition from vested interests.

In the first place, there are banks and institutional investors which oppose a CTT because they benefit from financial market volatility. They would lose profits in the order of 10 billion US-$. The following scenario shows what is at stake here:

- assume the redirecting function of a CTT reduces financial flows by one third, an amount of 120 trillion US-$ per year;
- assume further an average profit margin of 5 basis points (BP);
- then the CTT will cut profits by 60 billion US-$, which someone would have made without the tax (cf. Table 3).

Compare this with the aggregated official development assistance by all OECD countries which was less than 50 billion US-$ in 1998 (cf. OECD 2000).

Naturally, those who will miss profit chances of this magnitude oppose the CTT most fiercely. In their resistance, they can count on the neoliberal Zeitgeist which denounces any tax on corporations as competitive disadvantage. Even manufacture firms like Daimler-Chrysler tell their shareholders proudly that they have avoided all direct taxes. But the final verdict on the Zeitgeist is already to be found in Goethe's Faust: "What you call the spirit of the time, is nothing but the rulers' spirit." In this spirit, the prevailing discourse on taxes should be attacked full front in order to make clear that a CTT is not like a VAT which everyone pays for but a tax that collects the money where it is abundant. The CTT has thus also a redistribute function – from top to bottom. One can also argue on the grounds of social justice for the tax in order to gain more political support.

Another political argument in support of a CTT is the increased scope for regulative policy national governments gain from the tax (at the expense of financial market influence). This is not only a question of financial politics. Cutting back the influence of financial markets and gaining more scope for political action is a fundamental democratic objective. When the Deutsche Bank CEO Breuer says, that "investors no longer have to adjust their investments to the opportunities the government grants them, but governments have to adapt to investors' desires" and claims, in fact, that alongside with the classical three powers in a democracy and mass media, financial markets are a fifth power in the state (Breuer 2000), this is a claim to power by a pre-democratic mind. In sharp contrast to bank boards, shareholders, and fund managers, governments are democratically legitimised.

TABLE 3

Profit Losses due to a CTT

transaction decline	transaction decline	profits lost (US-$ bn)	
(in %)	(US-$ bn)	at a 5 BP margin	at a 10 BP margin
10	36.000	18	36
25	90.000	45	90
33,3	120.000	60	120
50	180.000	90	180

Source: BIS, our calculation

Presumably, Breuer gives a proper description of the current state of affairs. This would also explain the stubborn rejection of the CTT idea by some governments. In particular the US government tries to block any initiative in the direction of international taxes. This position has even been moulded into law. The US tax law for the fiscal year 2000 makes all contributions to the UN conditional on the fact, that "the UN is not engaged in any effort to implement or impose any taxation on United States persons in order to raise revenue for the United Nations or any of its specialized agencies" (Public Law 106-113 of 29 Nov 1999, H.R. 3194, Sec. 561).

10 Civil Society Must Have Its Say

Against those stern opposers of the tax, the front of supporters is building up rapidly. On the part of civil society, more and more are committed to the project of CTT. Financial markets have a huge impact on everyday life even when they function smoothly, let alone during crises. There is no reason to leave this field to bankers and fund managers.

In Germany, an increasing number of groups are demanding more control and regulation of financial markets. A network of associations, NGOs, local groups, and individuals has built up, including the trade union ÖTV, BUND, WEED, pax christi, the ecumenical network KAIROS Europe, Medico International and many initiatives and organisations. This network ATTAC Deutschland (www. attac-netzwerk.de) has joined the international ATTAC network. Among their goals is that of initiating a debate over the CTT both among the public and within the political system. Support for the international appeal for parliamentarians in favour of the installation of Tobin type tax shall be raised in the German parliament, too (cf. http://tobintaxcall.free.fr/allemand.htm). The UN conference on financing for development and Rio + 10 provide excellent opportunities for public debate and attention.

The joint declaration of the AFL-CIO and the Federation of German Trade Unions (DGB) is an encouraging step. It shows that even in the US, where the government and the financial sector fight fiercely against the tax, there are forces which opt for a change.

The campaign for a CTT is a challenge to the prevailing economic paradigm. Still, it is not a

desperate struggle. What matters is that the balance of power is shifted in favour of the Tobin tax such that it becomes politically feasible. To this end, public pressure, national co-operation with parties and governments, and international network formation by civil society actors are necessary. As we have learnt from the campaign for ecological taxes in Germany, the struggle is hard and long, but successful in the end.

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