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Stabilizing the International Financial System and Financing Development: An Analysis of the Tobin Tax

Edoardo Raviol¹

December 2007

Abstract

This paper analyzes the feasibility of an international tax on currency transaction, also known as “Tobin Tax”, from an economic and juridical point of view. The claim that such a tax would curb short term speculators, thus stabilizing the foreign exchange market, is discussed. Moreover, the potential revenues of such a tax are evaluated, along with some possible needs these revenues could address: financing developing and the attainment of the Millennium Development Goals, and global public goods. Part one focuses on the thirty-year-old academic debate sparked by James Tobin's proposal; part two describes the features of an hypothetical Currency Transaction Tax (CTT), while part three analyzes how a CTT could be implemented both within the European Union framework, or more generally through an ad hoc international organization.

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Introduction

This paper analyzes in its main aspects the implementation and functioning of a global tax levied on currency transactions, also known as “Tobin tax”. In doing so, it will try not to adopt a purely economic perspective – as many other studies have already done – but to integrate it with a juridic approach and with considerations over the political feasibility of such a proposal.

The topic is not really on the main headlines of the media, on the contrary it is quite forgotten by the public debate. In spite of this, there is a vast production of studies, books, researches on this subject and more generally on global taxes. A reason for this lack of interest may be that they are an attempt of regulating markets and capital flows. In this sense, they are in contrast to the creed of the big centres of economic power, consisting of liberism, deregulation and full liberalization of capitals movements.

Nevertheless global taxes are a very important matter to study, since they could be part of an answer to the big problems of today's world. These range from poverty to malnutrition, from instability in financial markets to ever-increasing inequality in the distribution of income – both between rich and poor countries, and between the rich and the poor of the very same country. It is difficult to imagine that liberalization and deregulations alone can solve these troubles. Instead of merely deregulating, the right approach may be to regulate better. This may prove particularly true for financial markets which, from 1971 on, have seen a gradual collapse of the old rules without any real alternative system replacing them. A Currency Transaction Tax could be the right answer, restoring some control on the flows of capital and at the same time raising revenue to intervene on problems such as those mentioned above. This work would like to give a small contribution towards assessing whether the proposed solution may be effective or not.

The analysis starts from an excursus of the thirty year-old academic debate that followed Tobin's first proposal in 1972. Part one presents the original proposition together with the amendments that Tobin himself and other scholars subsequently made. It also explains what are the goals that the Currency Transaction Tax – like any other tax – wants to achieve and why the idea, after three decades, is still alive and with many supporters. Finally, paragraph 1.3 tries to foresee what the foreign exchange market's reaction would be, were a CTT actually implemented. Venturing on this kind of speculation is very difficult, since no empirical evidence concerning such a tax is available. Nevertheless this point is extremely important to understand whether the distorting effects of the tax on the markets would be too big to be counterbalanced by its positive potential.

Part two addresses the issue of the tax implementation, explaining what features it would have. Each paragraph deals with a different issue, such as the transactions covered by the tax, its rate and what its proceeds could finance. With regard to this last topic, an estimate of the revenue potential is presented, together with some examples of the necessities it could address. A long paragraph is devoted to the problems related to the tax administration – i.e. who would be in charge of levying it and managing its revenues. This issue has a strategic importance with regard to the political feasibility of the tax itself. In the same paragraph the proposal of instituting an International Tax Organization is also described. It is a proposition not directly linked with the Currency Transaction Tax, but it underlines a diffused perception that it is necessary to intervene in regulating, or at least supervising, global taxation policy.

Finally, part three shows that, after all these theoretical proposals, something has already been concretely implemented. The juridic aspect of the CTT implementation is here taken into account. Although both the French and the Belgian law introducing a CTT are not yet enforced – since they require the participation of all EU members – they show that feasibility problems can be overcome, provided there is a strong political will to introduce such a legislation. However, since the CTT remains a global tax, the best way to implement it is through an international agreement. This *first best* solution is precisely what is discussed in paragraph 3.3., which concludes the work.

1. The CTT: what it is

The acronym “CTT” stands for “Currency Transaction Tax”, i.e. a tax which would be levied every time a foreign currency is changed into another (is traded across borders). This proposal is also known as “Tobin Tax”, named after the economist James Tobin who was the first to publish it.

1.1 A brief history of the academic debate

Professor James Tobin first suggested the idea of a currency transactions tax in 1972. His proposal was for a charge of between 0.1 and 1% on the conversion of one currency into another. Its main purpose was stated in a phrase that later happened to become a sort of manifesto: “a tax to throw some sand in the well-greased wheels of international finance.”¹

¹ Tobin (1972), *The New Economics: One Decade Older*, Princeton University Press, pp.88-93.

Indeed the proposal was not entirely original: in 1936 John Maynard Keynes had already drawn attention to the possible role of transaction taxes in favoring long-term investment over short-term speculation.² By the time professor Tobin resumed this intuition, the structure of the international financial system had evolved dramatically. The Bretton Woods system of adjustable pegged exchange rate regimes with capital controls was collapsing without a viable alternative being proposed, except for a mere deregulation of the old rules. In this context, Tobin's proposal was first and foremost meant to give stability to the currency markets.

During the Seventies and the Eighties the academic community simply ignored the idea. From time to time some interest was triggered by currency crises but died when the crisis passed from the headlines. It was only during the Nineties that the global public opinion became gradually aware of the possibility to levy global taxes such as the one devised by Tobin.

This happened for two different reasons.

- The first was undoubtedly the unprecedented series of currency crises that affected the financial markets during the decade. To cite some examples: the events in the Exchange Rate Mechanism (ERM)³ of September 1992, which severely affected the Italian lira and whose memory is still vivid in the Italians' minds, the crises of the Mexican peso in 1995, the fall of the South- East Asian currencies in 1997, of the Russian rouble or of the Brazilian real in 1999. These facts show that the global currency market was growing more and more in terms of volumes,⁴ but also in volatility and instability. Moreover, many of these crises were triggered not by a major change in the macroeconomic outlook of the country, but simply by the sudden move of speculators starting to sell massively the currency. In other words these were typical examples of “self-fulfilling crises”, i.e. crises provoked by nothing else than the very belief of the markets in a probable crisis. What was particularly striking for an outside observer was the absolute impotence of the affected governments. After a period of costly and ineffective resistance to markets' pressures, they were forced to devalue the currency, therefore fulfilling the markets' expectations. The social and economic consequences of these events were nevertheless devastating and were to be borne by the country's economy and population for several years to come.

² Keynes (1936), *The General Theory of Employment, Interest and Money*, Harcourt, Brace and Co.

³ The ERM was an exchange rate system among the European Community Members' currencies in order to enhance stability in the exchange markets. It was firstly introduced in 1979, when each currency set a fixed fluctuation band against the European Currency Unit (ECU), a weighted basket of members' currencies.

⁴ See *graph 1*, p. 8.

- The second source of interest in the proposal was its potential as a generator of revenue, that could be dedicated to multilateral purposes. With regard to this, it is important to stress that this aspect of the introduction of the tax was not present in Tobin's first proposal. He suggested this possible use of the sums collected only in 1978 and considering it as a “by-product” of the tax, not as its principal goal.⁵

For the above-mentioned reasons, the Currency Transaction Tax became, at long last, a credible matter of discussion, arising a fervent academic debate that enriched Tobin's original idea with fundamental contributions as well as well-founded critics. Particularly relevant to our analysis is the contribution of the German economist Paul Bernd Spahn. His work stems with the observation that a tax rate as low as the one proposed by Tobin and other authors (0,1% or lower, to a minimum of 0,01%) would do little to prevent self-fulfilling crises. In these particular conditions, substantial financial gains are assured for speculators who take a position against the viability of the currency pegs, as in the ERM crisis. Empirical evidence suggests that, for example, to prevent the speculative surge of the Mexican peso crisis of 1994/'95, a CTT exceeding 23% would have been needed.⁶ Yet, such a high tax rate would create severe liquidity problems for the normal functioning of the markets. In fact a liquid currency market is a desirable condition, necessary for the sustainability of today's world economy, based as it is on global trade, capital mobility interdependence between national economies etc.. Too high rates risk reducing liquidity, which is necessary for arbitrage operations. These perform the important functions of reducing price volatility, settlement risk, and the cost of hedging. Such rates may even deter international trade transactions and long-term investment.

We are consequently facing a trade-off between high tax rates preventing currency crises and low rates allowing the normal functioning of the market. In order to solve this dilemma Spahn proposes a flexible, multi-tier system of tax rates, rather than a one-size-fits-all, time invariant currency tax. The two-tier structure consists of “a low tax rate for normal transactions and an *exchange surcharge* on profits from very short-term transactions deemed to be speculative attacks on currencies.”⁷

Practically:

- in normal times a tax rate of between 0,01 and 0,1% is applied to all foreign exchange

⁵ Tobin (1978), “A Proposal for International Monetary Reform”, Eastern Economic Journal, Vol. 4 (July-October), pp. 153-59.

⁶ Davidson, (1997), “Are Grains of Sand in the Wheels of International Finance Sufficient to do the Job When Boulders are Often Required?”, The Economic Journal, 107(442):671-86.

⁷ Spahn (1996), “The Tobin Tax and Exchange Rate Stability”. World Bank Finance & Development.

transactions and to all financial transactions taking place in the secondary market of financial derivatives, raising substantial and stable revenues without altering significantly the foreign exchange market;

- whenever the effective exchange rate transgresses an agreed band, a special exchange surcharge acting as an “antispeculation device” would be levied on the discrepancy between the market exchange rate and the closest margin of the band.

However, the system resulting would not be one of fixed exchange rates, since the threshold would be determined by a crawling peg, based on a moving average of the exchange rate in relation to a weighed basket of the most relevant foreign currencies for that country. Thus, the moving band allows gradual fluctuations of the currency value, broadly reflecting changes in the macroeconomic *fundamentals* – i.e. interest rates, wages, inflation, unemployment,... On the other hand, swift upward or downward movements – which could trigger self-fulfilling crises – are prevented by the introduction of the exchange surcharge, which could reach a maximum rate of 80%.

It may be worth noting that there are other proposed solutions for averting self-fulfilling currency crises besides a multi-tier CTT. Roughly, they can be divided in three main groups: a) pure floating; b) hard pegs to another currency or to a basket of currencies; c) soft bands, when the exchange rate is allowed to move outside the band in the short run, at times of shock to the fundamentals. Naturally, both hard pegs and soft bands are stabilizing when market operators believe in the government's commitment and ability to intervene to defend the edges of the zone. With regard to this it is to stress, by contrast, the simplicity and flexibility incorporated in the two-tier CTT solution, in which authorities would not choose to set and defend a particular parity, but rather to prevent self-fulfilling panic.

1.2 The main purposes of the tax

According to its supporters, a Currency Transaction Tax should be introduced on these grounds:

1. to preserve and promote autonomy of national macroeconomic and monetary policies;
2. to make exchange rates reflect to a larger degree long-run fundamentals relative to short-range expectations; by doing so to reduce exchange-rate volatility;
3. to raise revenue as a means of funding development and/or the provision of global public

goods and/or the attainment of the UN Millennium Development Goals (MDGs)⁸

Of the three, the first two are precisely the problems that Professor Tobin himself wanted to address when he wrote for the first time on a currency transactions tax.⁹ On the contrary, as we have already explained, he considered only in a second time the potential revenue generated, which was not his main objective. Nowadays, ironically, most of the interest in the proposal lies in the possible uses of the sums collected (*see paragraph 2.4*). Now let's start with analyzing more in depth the discussions relative to the tax main advantages and drawbacks.

As far as the first objective is concerned – i.e. restoring economic policy autonomy at national level –, the matter raises a number of issues. Indeed the free movement of capital on an international scale has reduced the ability of national economies to conduct monetary and other economic policies on the basis of purely domestic criteria. In today's global financial markets, deviating from the international interest rates that markets have decided condemns countries, and especially developing countries, to capital outflows and currency attacks. If a democratically elected government chooses an alternative economic policy based – among other elements – on low interest rates, it will be sanctioned by financial markets. There is no other solution to this problem than endorsing the fact that market freedom, excessive liquidity and unconstrained arbitrage must be restricted. However, critics can argue that exposure to international exchange and financial markets exerts a valuable discipline on national governments, which might otherwise be tempted to follow inflationary policies.

Reducing exchange rates volatility, thus stabilizing the foreign exchange market is undoubtedly the most important and ambitious goal of the CTT. Whether it could succeed in doing so is widely debated between economists and the positions can diverge substantially. First of all, it is universally agreed that exchange rates can be stabilized in different ways, not only by a Tobin tax. The most obvious way to stop speculation in foreign exchange markets is to abolish separate currencies, as within the EU. At present though, the idea of a “world currency” would be politically problematic, to say the least. Nevertheless various “*second best*” solutions exist, ranging from direct controls on changing currencies and on the movement of capital, to the return to fixed exchange rates, to transaction or other taxes. Naturally, each of these policies present small or great risks to discuss. For example, measures like restrictions to the right to

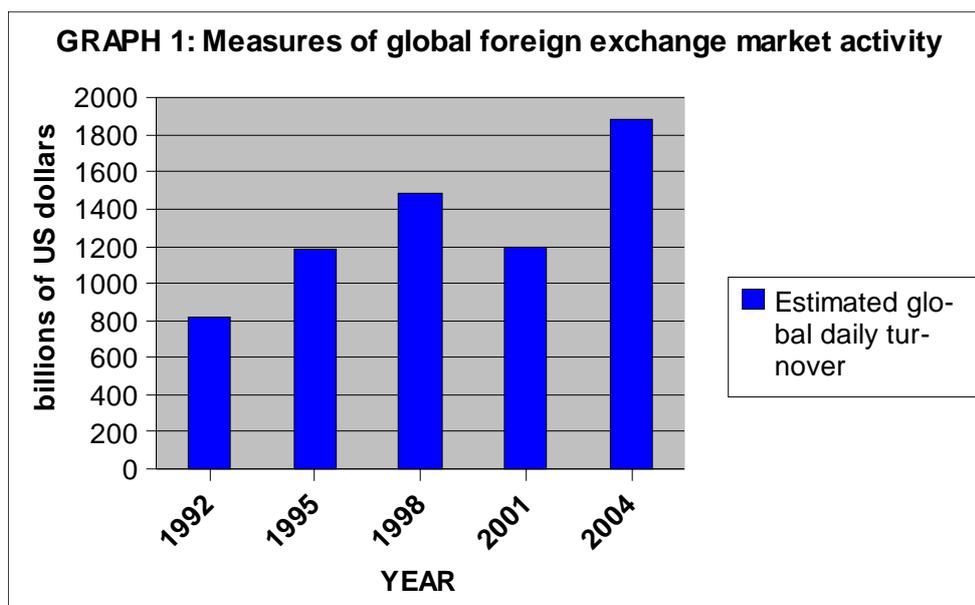
⁸ For an explanation of the Millennium Development Goals, see paragraph 2.4, p. 21-23.

⁹ Tobin (1996), “*Prologue*”, in M. ul Haq, I. Kaul and I. Grunberg (eds.), “*The Tobin Tax – Coping with Financial Volatility*”, Oxford University Press, pages xii, xiii

change one currency into another, despite being common some 30 years ago, would nowadays undoubtedly be illegal under IMF (and WTO) rules. Another problem is that the exchange rate of the currency concerned may eventually bear little relation to economic fundamentals. Fixed exchange rates present the inconvenience of having to be set unilaterally and periodically adjusted to hold account of the change in the fundamentals of the different economies. Taxes on foreign exchange transactions introduced by a single country would merely transfer business from its own financial institutions to foreign competitors, while speculation against its currency would continue elsewhere. In fact their evasion would be extremely easy, requiring only a swift relocation of the dealing sites. To sum up, the big advantage of a Tobin tax compared to these or other measures is that it would be administrated multilaterally, avoiding the temptation for any single country to return to “beggar-thy-neighbor” policies disguised as “anti-speculative”. Indeed, removing restrictions on flows of capital has had an overall beneficial effect on the international economy, and a general return to exchange controls, inconvertibility of currencies and similar devices would probably plunge the world into deep recession. The aim of more sophisticated proposals – such as the Tobin Tax itself – is therefore to maintain the free movement of capital for productive, wealth-creating purposes, while limiting speculative and destabilizing movements.

1.3 Possible effects of its introduction on the foreign exchange market

To understand what consequences a Currency Transaction Tax could have on the foreign exchange (forex) market it is important to have a preliminary look at the market itself.



source: author's elaboration based on data from BIS (2004)

The value of international exchange transactions is generally estimated at between 1 and 1.9 trillion dollars each day; a mere 5% of this sum is directly related to settlements for traded goods and services. In the early 1970s, prior to the liberalization of the world's capital markets, the value of currency trading was only six times greater than the value of "real" trade.¹⁰

Over half the transactions are turned around within a week. Of course not all the remaining 95% of transactions can be classified as "unproductive speculation". Many are for insurance purposes, including forward currency operations to hedge against possible movements in exchange rates between the conclusion of a contract and final settlement – known as *exchange risk*. These transactions are also important for the development of real international trade. A substantial proportion of currency transactions are also for the purpose of *arbitrage*.¹¹ Although such operations are not directly connected to the "real" economy, they can be important in eliminating variations in prices – including interest and exchange rates – between different markets, and hence in enabling the global economy as a whole to operate more efficiently. The effect is to reduce rather than increase exchange-rate volatility.

Another characteristic of the forex market is its increasing centralization; big interbank

¹⁰ Sources: BIS (2004) *Triennial Central Bank Survey of Foreign Exchange Market Activity 2004*, and "The Economist", 25th September 1997 and 9th December 2004.

¹¹ *arbitrage*: multiple financial operation consisting in the buying of titles or currencies and in the selling of the same asset with the intention of gaining a profit given by the difference between the two prices on two different markets.

systems (like EBS, Reuters or the newly-devised Continuous Link Settlement Bank)¹² process a big share of the transactions that take place each day. This trend could be very interesting with regard to the introduction of a CTT, since the tax collection may be relatively easy compared to what previously thought. However, interbank trade is less dominant than it was. Hedge funds and other non-bank financial groups trading with banks now account for 33% of volume, up from 28% in 2001 and 20% in 1998.¹³ These actors can exert a great influence over the market: the IMF estimates that hedge funds can mobilize between 600 billion and 1 trillion dollars to bet against currencies and other assets – for example, selling a currency forward in the hope that they can buy it back later at a cheaper rate.¹⁴ To draw a comparison, the rich governments' combined official reserves stand at \$1.6 trillion. Of course, these huge amounts of capital are guided by the speculators' own appetite for profit. But speculators do not select their targets randomly. It is true that their objective is to make money, but the best way to do this in the long term is to spot currencies that are out of line with economic fundamentals, and whose price is therefore likely to change. The devaluations of the sterling and the lira in 1992, of the Mexican peso in 1994 and of South-East Asian currencies in 1997 reflected economic imbalances. The changes in the prices of these currencies were necessary anyway; the speculators, arguably, just anticipated the change. However, it is important to stress the difference between currency markets and, for example, shares markets: a fall of 20% in the price of a particular share will have limited economic repercussions; by contrast, a sudden drop of 20% in the price of a currency may provoke bankruptcies, massive layoffs, the country falling into recession and taking several years to recover and foreign countries to block imports; in other words the social consequences of the speculators' economic-driven actions may be disproportionate. The problem is that all financial markets, from currencies to shares, are subject to waves of excessive optimism followed by excessive pessimism. In theory, speculation should be stabilising: to make money, investors need to buy when the price is low and sell when it is high. However, in a bubble it is profitable to buy even when the price of an asset is high, as long as it is expected to rise further—until the bubble bursts.

To sum up, it is almost impossible to distinguish between stabilizing arbitrageurs and short-term, market-distorting speculators – also known as *noise traders*. Critics of the CTT focused precisely on the fact that it would tax all transactions – speculative currency dealings, but also

¹² The CLS Bank is a purpose-built bank in New York that undertakes to settle foreign-exchange trades among the world's 60-or-so biggest banks (see “The Economist”, *Plumbing revolution*, 14th November 2002)

¹³ BIS (2004).

¹⁴ “The Economist”, *Mahathir, Soros and the currency markets*, 25th September 1997.

long-term capital investments and dealings to finance trade – thus reducing market efficiency. In particular, the possible reduction in the liquidity of the market is considered the biggest drawback of the proposal, which could overshadow all its positive effects. These worries seems exaggerated to many authors.¹⁵ In fact it is difficult to imagine what has been defined by The Economist “the world's most liquid market”¹⁶ facing serious liquidity problems. More plausibly, the volumes traded would simply shrink to the levels of some years ago, which nevertheless guaranteed a viable market.

Furthermore, another reason why the liquidity problem should not be overestimated is the tax impact. Recent studies suggest CTT rates much lower than originally proposed by Tobin. From the 1% levy initially hypothesized, the figure has dropped towards a few basis points.¹⁷ Such a moderate rate would not cause transaction costs to raise dramatically, thus leaving markets volumes virtually unaffected.

¹⁵ See for example Palley (2003), *The Economic Case for the Tobin Tax*, in J. Weaver, R. Dodd and J. Baker, (eds.) *Debating the Tobin Tax*, New Rules for Global Finance Coalition, Washington, DC.

¹⁶ “The Economist”, *Free for all*, 9th December 2004.

¹⁷ The term *basis point* is used to refer to a ten-thousandth (0.0001 = 0.01%).

2. How would a CTT work?

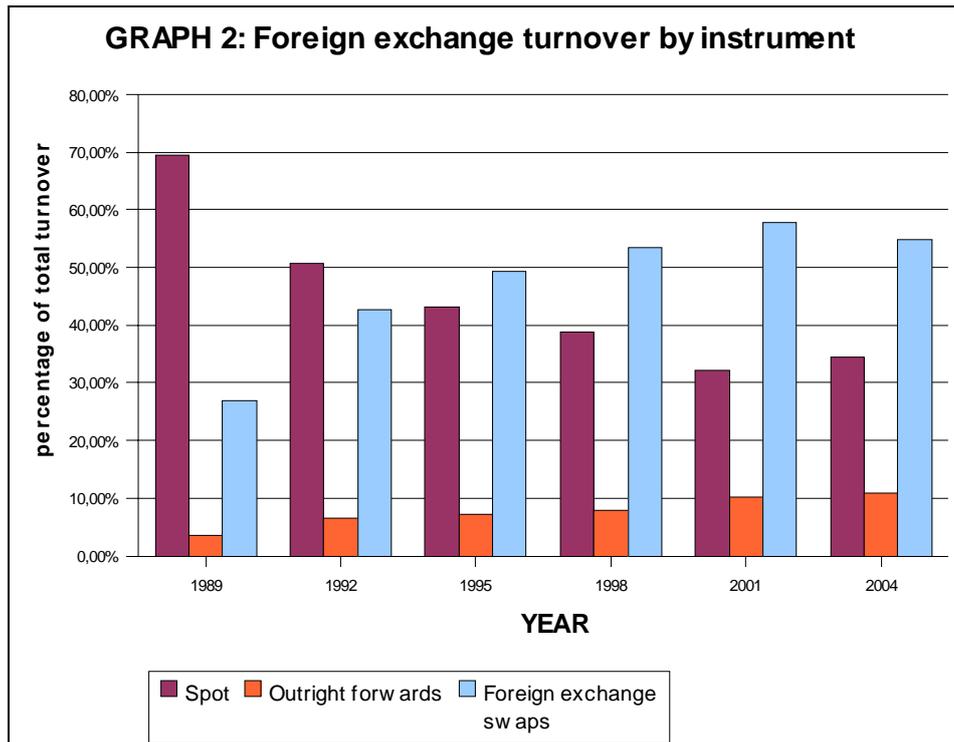
This part will be devoted to analyze the main aspects of the introduction of a Currency Transaction Tax, without entering the technicalities related to each of them. As the debate concerning the Tobin Tax grows, so does the number of authors who propose their own version, each coming with minor or major amendments to the original one. This part does not claim to be a survey of all the proposals. On the contrary it tries to present and discuss, for each aspect analyzed, Tobin's original position together with some of the most important, interesting or innovative contributions that have been made during the thirty-year debate that stemmed from his idea.

2.1 The tax base – What would the CTT tax?

The first characteristic to define when analyzing any tax is its scope – i.e. what it does actually tax. At the macro-economic level, what is subject to a tax is defined as the “tax base”. In the first part the CTT has already been defined as “a tax on the conversion of one currency into another”. Here we will try to be more precise and specify what currency transactions would be taxable.

Professor Tobin initially thought of a tax confined to spot transactions, without the need to tax derivatives,¹⁸ except at the time and to the extent that they were settled by spot transactions in currencies. However, this limited application is likely to be inadequate, because it would be easy to avoid the tax by trading in financial derivatives. The importance of these instruments has grown rapidly over the past years and now they account for a significant share of all foreign exchange transactions (*see graph 2*).

¹⁸ *Financial derivatives* are contracts concerning the buying/selling of a certain asset (called *underlying*) on a future date and at a pre-defined price (called *strike price*). The underlying can be raw materials, currencies, interest rates, shares, stock exchange indices. The main categories of derivatives are: futures, options, warrants, forwards, swaps.



source: author's elaboration based on data from BIS (2004)

The graph shows the gradual fall of the share of spot transactions in favor of foreign exchange swaps. These data underline the importance to tax derivative instruments as well, not to lose a substantial share of the tax base. Nevertheless taxing them poses some relevant problems. Simply levying the tax on the spot transactions that settle the derivative instrument would grossly understate the volume of funds that can be channeled through these markets; on the other hand, taxing the notional value of the contract – which is, by definition, very high though never fully paid up by the parties – may completely destroy the derivative market itself. Given its essential role in hedging currency risks, this outcome would be highly undesirable. A possible answer to the problem, proposed by Spahn, would be to tax anyway the face value of the instrument, but at a lower rate¹⁹ – e.g. half the normal rate for spot transactions. This solution – though considered far from ideal by Spahn himself – has nevertheless found supporters and is included in some of the propositions analyzed in chapter 3.

Another problem is envisaged by some authors: markets may devise new financial products instead of using those subject to the tax in order to avoid it.²⁰ For example, trading could shift

¹⁹ See Spahn (1996), *op. cit.*

²⁰ See for example Patterson and Galliano (1999), *The feasibility of an international "Tobin tax"*, European Parliament, Economic Affairs Series, ECON 107 EN (PE 168.215).

into cash-substitutes such as Treasury bills or other assets. However, Professor Tobin did not seem too worried about this possibility. Widening the tax scope to cover the loophole of Treasury bonds is feasible, while further enlargements should not be necessary. Actually, transforming other assets into liquidity should imply greater costs than the tax they are meant to evade.²¹

Once the transactions affected by the tax have been defined, it can be discussed whether the tax must always be levied or exemptions have to be granted to certain actors. For example, since the objective remains that of stabilizing the financial system and not that of maximizing revenue, it would make little sense to tax transactions conducted by central banks, which undoubtedly intervene in order to stabilize the markets and not for speculative reasons. Another sensible exemption may be made on transfers from governments to international bodies. Furthermore, exemptions should be provided for transactions below a certain threshold. For example, a tourist changing 500 dollars for euros, supposing a rate of 0,1%, would have to pay 50 cents of tax. It is evident how even the time and effort to collect the tax are not worth the trifle paid over. The most recurrent threshold which has been proposed is 10,000 euro – or its equivalent if other currencies are involved in the transaction – since it would be in line with the current EU legislation on money laundering. There is, however, the risk that a bigger transaction may be split into several smaller to stay under the limit and not be taxed. Again, the costs arising from such an operation might be bigger than the evaded tax. Moreover, to avoid this kind of evasion, the agreed threshold may be calculated not on the value of the single transaction, but rather to the annual taxable amount of each taxpayer.

Another question has been discussed: should every transaction conducted by banks and other financial intermediaries be taxed or should the tax be levied only on the end-of-day net variation in their open position? Tobin leaves the door open for this second possibility. Actually most transactions are done between banks and dealers, in order to maintain balanced positions. Therefore those transactions should not affect exchange rates. Moreover the margins in such deals, as well as in the interbank market, are very small, so there would be little room for a tax. Nevertheless this conclusion is not widely accepted and most of the authors fully include the interbank and wholesale markets in the CTT tax base.

After all these limitations and exemptions, it becomes quite difficult to assess what the tax base of a Currency Transaction Tax could be. Estimates will be reported in paragraph 2.4.

²¹ Tobin (1996) *Prologue, op. cit.*, p. xv.

2.2 Rates

After having defined which operations would be subject to the CTT, it is the turn to specify what percentage of each transaction would be levied – i.e. the tax rate. Tobin's original proposal was for a 1% tax, in order to deter short-term financial round-trip excursions into another currency without entailing a discernible disincentive to long-term investments.²² Later, as other contributions were made, Tobin himself recognized that the tax rate had to be lower, not to swamp the normal commission charged.²³ The most widely-accepted figure has therefore become 0,1%, “*qui ne pénaliserait pas les investissements à dix ans mais les placements à dix jours,*” as former French prime minister Lionel Jospin said in 1995.²⁴ However, several authors have come to the conclusion that an even lower rate should be applied, putting the figure at 0.02-0.01%, i.e. one or two basis points.²⁵ The lower rates are favoured on the basis of the growing recognition that a loss of liquidity resulting from the CTT should be kept to a minimum. In this way transaction costs as well as trade volumes and market structures would not be adversely affected.²⁶ It is assumed that a modest tax rate of 0.1 per cent or lower would not entail a discernible disincentive to long-term investments or international trade, as the tax could be a very marginal part of other larger trade- and investment-related transaction costs.

In short, this debate implies a trade-off between higher revenues/higher anti-speculation scope and fewer market distortions. The higher the rate levied, the more revenue generated, but also the bigger the distortions to the market, and the greater the loss of liquidity. Last but not least, an higher rate implies a greater incentive to find ways of evading the tax. On the other hand, a lower levy has less teeth to curb speculation. However, as already explained in paragraph 1.1, this drawback has been addressed by Spahn's two-tier system: a low levy during normal times and a much-higher exchange surcharge to block speculations during currency crises. These would be identified by the overshooting of an agreed, fluctuating band by the exchange rate. The definition of the criteria for this band is of extreme importance, since it determines the flexibility of the foreign exchange market, i.e. the speed at which a currency is allowed to appreciate/depreciate without incurring in the exchange surcharge, which would virtually block

²² Tobin (1978), *op. cit.*, pp. 153-159.

²³ Tobin (1996), *Prologue, op. cit.*, p. xvii.

²⁴ Jospin (1995), *1995-2000, Propositions pour la France.*

²⁵ See for example Spahn (1996), *op. cit.*; Nissanke (2004), *Revenue potential of the Tobin Tax for development finance: a critical appraisal*, in A. B. Atkinson (ed.), *New Sources of Development Finance*, Nuffield College, Oxford University Press.

²⁶ For the debate over liquidity see paragraph 1.3

all transactions. Spahn himself proposed the use of a “crawling peg” – i.e. a moving average of the exchange rate of a currency in relation to a weighed basket of the most relevant foreign currencies for that country. The shorter the time interval for the crawl, the greater the scope for short-term fluctuations. By contrast, a too long interval would result in a rigid band, similar to a fixed exchange rate. The interval should therefore be short enough to avoid sustaining an exchange rate against macroeconomic trends so that markets can fully adjust to changes in fundamentals.²⁷ A consensus has grown over an interval of about twenty days, which would be a good compromise between the two above-mentioned requirements.

Returning to the debate over the ideal tax rate, this work embraces Spahn's proposal as the most prudent and sensible: levying two basis points on spot transactions, one basis point on derivatives and the threat of the exchange surcharge to deter speculative attacks. Thus the tax could be collected also on the wholesale market, where the margins stand at about 0.1% or even lower. This would not affect the structure of the international financial system, neither provoking a shift in the operators' habits, nor producing big incentives to evade the levy. It is recommendable a gradual and prudent approach to the introduction of the CTT, initially keeping the rate as low as possible. Then, after a trial period, if the markets reaction were positive, it would still be possible to agree a raise in the tax burden.

A final question needs to be addressed after this debate: with such low rates as the ones hypothesized here (one or two basis point), would the revenue raised still be high enough to justify the big political and technical efforts required to introduce the CTT? This issue is addressed in paragraph 2.4, in which the potential revenue will be assessed.

2.3 Collecting the tax and the ITO proposal

Before estimating the money the CTT could raise, the issue of who would be in charge of levying and administrating it should be considered. First of all, since the Tobin tax is an international tax, it would inevitably require some cooperation between the countries introducing it. It has already been underlined the almost complete inefficacy of its unilateral implementation.²⁸ The measure should therefore be applied in concert by at least all the key countries. The degree of cooperation required could range from a minimum of using the existing

²⁷ Spahn (1996), *op. cit.*

²⁸ See paragraph 1.2, p. 12.

international forums to discuss a standard and uniform enforcement, to a maximum of creating new bodies to which member States would give a part of their sovereignty. This alternative is analyzed later in this paragraph and in paragraph 3.3.

However, the right to levy and collect taxes resides in the state itself, as an essential sphere of its sovereignty. It is difficult to imagine a government renouncing to this right, allowing an international organization to collect a tax on its own territory. For this reason, each country – via its own tax authority – would collect the tax on all payments within its jurisdiction, whether these involved the home currency or not. Another option, since banks and exchange transactions are under the supervision and regulation of the monetary authorities, is that CTTs be administered by monetary authorities rather than by tax authorities. Otherwise, the latter could administer and collect CTTs in cooperation with the formers and with access to information generated by the CLS Bank and other financial institutions.

Alternatively the administration of a transaction tax could be assigned to the IMF, as suggested by Tobin.²⁹ The introduction in the national legislation of a tax in compliance with IMF specifications could become a condition of membership and of borrowing privileges. The drawback is that implementing this measure would require amending the Fund's *Articles of Agreement*. Amendments, in turn, require an 85 per cent majority, which would be very difficult to achieve. In particular, the Fund's voting system provides that a country's voting weight depends upon its quota. Therefore, the size of the United States' quota gives it a *de facto* veto power over any decision requiring an 85 per cent majority. Considered that fierce opposition to the Tobin Tax has already been expressed by the current US administration and Congress,³⁰ the IMF introducing it does not seem a politically viable scenario, at least for the moment being. However, leaving aside for a while the political side of the matter, the IMF or the Bank for International Settlements (BIS) – or the two together – would be the logical administrators of all the technical details taken into account in this chapter: the rate of taxation, the definition of taxable transactions, the possible, temporary exemption of some currencies from the tax... Their role of would-be, if not yet actual governing bodies of the global financial system puts them in a unique, privileged position to perform these tasks.

Returning to politically feasible alternatives, Spahn, in the light of the reality faced by the international community, considers that the Tobin tax cannot be universally introduced in the

²⁹ Tobin (1996), *op. cit.*, pp. xiv-xv.

³⁰ Nissanke (2004), pp. 13-14.

first instance.³¹ A possible solution could be its initial implementation by a group of countries such as the European Union in cooperation with Switzerland, through an international agreement similar to the one that will be hypothesized in paragraph 4.3. Subsequently, other countries could gradually be lured into joining the club.

A radical alternative to the very introduction of a CTT has been advanced by Mendez.³² He suggests the establishment of a global “foreign currency exchange” (FXE) under the UN system. This centralized exchange, as a public owned entity in the form of a specialized agency, would be a global network of members including frequent users as well as brokers and dealers. Participants would pay a licensing fee as well as commissions on each transaction. These licensing and user fees would constitute revenues, instead of a CTT. A Tobin type of tax could nonetheless be implemented under this system, with a view of reducing volatility. However, under the current international climate, reaching an international agreement for creating and organizing such a global currency market under the UN system might be even more difficult than with CTTs.

The proposal of an International Tax Organization (ITO).

As far as the collection of a global tax – such as the CTT is – is concerned, it may be relevant to give an account of the debate going on with regard to the need for an International Tax Organization. This idea was firstly evoked by Tanzi,³³ and subsequently revived by a *Report on Financing for Development* commissioned by UN Secretary General Kofi Annan in December 2000.³⁴ This paper makes recommendations on how to address the problems of today's globalization, which, far from being inclusive, has brought greater prosperity and human development along with increasing inequalities and polarization. Dealing with these issues, it advances the proposal to create an International Tax Organization (ITO), aimed at enhancing

³¹ Spahn (2002), *On the Feasibility of a Tax on Foreign Exchange Transactions*, Goethe-Universität, Frankfurt

am Main.

³² Mendez (2001), *The Case for Global Taxes: an Overview*, Paper presented to the United Nations ad hoc

Expert Group Meeting on Innovations in Mobilising Global Resources for Development, 25-26 June, United

Nations, New York.

³³ See Tanzi (1999), “*Is There a Need for a World Tax Organization?*” in A. Razin and E. Sadka, eds., *The*

Economics of Globalization: Policy Perspectives from Public Economics. New York: Cambridge University

Press.

³⁴ *Report of the high-level panel on financing for development (the Zedillo Report)* (2001), United Nations,

New York.

international economic governance. Taxation is an area of economic policy strongly affected by globalization. As an example, it can be cited the *tax competition* among countries – especially developing ones. This consists in reducing taxes – particularly corporate ones – in order to attract foreign investment, but also in fear of asset migration and capital flight. What happens is that the enhanced mobility of capital allows it to escape the higher tax rates and broader tax base in the advanced industrial countries by migrating to less developed countries. The erosion of the tax base on capital has increased the burden of taxation on labour, thus raising labour costs. This eventually translates into higher unemployment. A possible explanation is that the tax systems of most countries evolved at a time when trade and capital movements were heavily restricted. The tax policies of other countries were a matter of marginal concern to policymakers. By contrast, in today's globalized world countries are increasingly competing not by devaluing their currencies – as in the “*beggar-thy-neighbour*” policies of the Thirties – but by offering low tax rates and other tax incentives.

All these considerations suggest that an International Tax Organization may have an important role with regard to taxation policy. Its duties could vary, depending on the power that Member States would concede to it. At the least, such an organisation could compile statistics, identify trends and problems, present reports, offer technical assistance, and provide a forum for the exchange of ideas and the development of norms for tax policy and tax administration.³⁵ As the IMF maintains surveillance of macroeconomic policies, the ITO could oversee tax developments. Moreover, it may take a leading role in restraining the tax competition designed to attract multinational corporations, as well as develop procedures for arbitration in case of disputes between countries on tax questions. More ambitious tasks would include developing a formula for the unitary taxation of multinationals and sponsoring a mechanism for multilateral sharing of tax information. This element is of great importance, since the mobility of capital can lead to the evasion of taxes on investment gains earned abroad. A similar problem is represented by the mobility of labour, i.e. by migrants. At present, most of them pay income taxes only to their host country. Such an arrangement is penalizing from source countries, especially if they are developing ones. It is common to see the most able and qualified part of the workforce of these nations emigrating to developed ones, a dynamic widely known as *brain drain*. Devising a mechanism under the ITO for the world-wide taxation of income regardless of where it has been

³⁵ These issues are already partially addressed by existing bodies, such as the OECD and IMF. However, membership in the OECD is restricted and the IMF merely provides technical assistance in tax administration.

earned may reduce the economic loss consequent to the brain drain, and even turn it into a benefit to the source country.³⁶

If the ITO were created, it may well take charge of the collection of international taxes – should they be introduced. In this regard, the Panel examines several proposals, in order to establish an appropriate global source of funds to permit the adequate financing of global public goods. The Tobin Tax is one of them, though not the most sponsored one. The Report's position is that

the merits of a currency transactions tax remain highly controversial. [...] Further rigorous study is needed before any definitive conclusion is reached on the feasibility and convenience of a Tobin tax.³⁷

Rather, it decidedly supports the implementation of a global tax on carbon emissions, which could take the form of a tax on the consumption of fossil fuels, at rates for each type of fuel that reflect its contribution to global carbon emissions.³⁸ However it must be stressed that the two proposals are not necessarily alternatives.

To sum up, the ITO proposal is still embryonic in that its functions are not clearly defined and there are not countries clearly committed to its creation. Yet the importance of overseeing and regulating taxation policy in today's globalized world makes a strong case for its institution. Even if it did not administer the CTT itself, the ITO would nonetheless be important for its implementation. Actually, the introduction of a Tobin Tax should not be viewed in isolation; on the contrary, it should be considered as a part – though maybe an essential one – of a package of reforms towards a new international financial architecture.

2.4 How much could the tax raise and who would benefit from it?

These questions, already anticipated in paragraphs 2.1 and 2.2., are of extreme importance for a complete evaluation of the CTT. It has already been stressed that the revenue potential was not Tobin's main worry. Today, by contrast, the political priority is not the stabilization of the foreign exchange markets, but rather financing development, in order to reduce the ever-growing inequalities of our globalized world. For this reason, it is essential to at least have an idea of how much a CTT could contribute to raise additional financial aid for developing countries. However, it must not be forgotten that the CTT scope is much wider, since it would create positive

³⁶ An analogous scheme is already in place in the United States, which require its nationals to pay U.S. taxes on their world-wide income regardless of where they reside. However, without an ITO to help with enforcement, most other countries would not have enough teeth to enact such a measure.

³⁷ *Zedillo Report, op. cit.*, p. 21.

³⁸ For a detailed description of the tax features and of the reasons why the Panel supports it, see the *Zedillo Report, op. cit.*, p. 21-22.

externalities which would increase the efficiency of the global economic system. Therefore, a comparison between this and other global sources of revenue – such as a carbon tax – should include these macro-economic aspects in its assessment.

Nevertheless, estimating the tax yield presents great difficulties. It is almost impossible to foresee on a scientific basis what the market's reaction to the tax would be. In economic terms, no estimate on the cost-elasticity of foreign exchange volumes is known a priori.³⁹ This is why the results of the calculations vary so widely between different authors. This essay adopts a method similar to those used by Nissanke (2004), though based on the most recent data available.⁴⁰

First of all, it is necessary to assess the taxable amount, bearing in mind the exemptions mentioned in paragraph 2.1; the tax rate will then be calculated on this sum to determine the tax revenues. The starting point of our calculations is 1.88 trillion dollars of daily net turnover in the foreign exchange markets in April 2004.⁴¹ The official transactions carried out by monetary authorities must be deducted from the tax base; their share in global turnover is assumed to be about 8%. Including other possible leakages, evasion, etc., a percentage of 10% is subtracted from the taxable amount as “non-taxed instruments”. Subsequently, the reduction in volume caused by the introduction of the tax has to be determined. The rate here adopted is 0.02% on spot transactions and half this value on derivative instruments. At this moderate rate, retail transaction volume is assumed to be virtually unaffected, while excessive noise trading in wholesale segments would be reduced by such a levy. Nissanke estimates that a 0.02 per cent tax would reduce the volume of wholesale transactions by 15 per cent – i.e. excluding transactions with non-financial customers.

An estimate of the CTT revenue potential under all the above-mentioned hypotheses is shown in Table 1.

³⁹ Cost-elasticity is defined as the ratio of the proportional variation of demand to the corresponding proportional variation of cost. It gives an indication of how sensible the demand is to changes in costs. In this specific case, how much would the market volume shrink in response to a tax which raised costs?

⁴⁰ See Nissanke (2004), *Revenue potential of the Tobin Tax for development finance: a critical appraisal*, *op. cit.*, in particular pp. 73-84.

⁴¹ Source: BIS (2004); the figure is net of local and cross-border inter-dealer double-counting and includes estimated gaps in reporting.

TABLE 1: CTT revenue estimate applied to 2004 foreign exchange trade volumes				
	daily turnover (billions of dollars)	Adjusted by trade volume reduction (tax rate 0.02%)	Tax rate	Revenue (millions of dollars)
total turnover	1.880			
BIS adjusted turnover	1773			
less "non-taxed instruments"	-177			
TAXABLE BASE	1.596			
of which				
a) spot transactions	550	478	0,02%	96
wholesale	478	407		
retail	71	71		
b) outright forward	172	152	0,01%	30
wholesale	136	115		
retail	37	37		
c) foreign exchange swaps	874	751	0,01%	150
wholesale	815	693		
retail	59	59		
Daily revenue (millions of US dollars)				276
ANNUAL CTT REVENUE (billions of US dollars)				69

source: author's calculations based on data from BIS (2004).

These calculations show that a CTT at two basis point would generate a annual revenue of about 70 billion US dollars. This figure is much lower than those suggested by other authors. The discrepancies are motivated by the differences in the underlying assumptions.

The use of CTT revenues.

After estimating how much could be raised with a Transaction Tax, it is now time to define what this revenue would be used for. Tobin's intent, as already explained, was primarily to restore autonomy of national macroeconomic and monetary policies. Consequently, a share of the tax yield should be reserved for national governments in order to enhance their freedom of manoeuvre, especially with regard to public expenditure.

Nevertheless, not all the revenue should be devoted to this purpose. Actually, since the CTT is an international tax (ideally even a global one), in that it requires some degree of cooperation between countries, also its proceeds should be administered multilaterally, in order to address needs which go beyond individual national interests. Problems to be dealt with do not lack. For clarity, the possible multilateral uses of the CTT revenue can be divided into two groups: financing development, thus offsetting the decline in official aid (ODA) from OECD countries, and providing or preserving *global public goods*.

The Millennium Development Goals (MDGs) can fall into the first category. They are

[...] the world's time-bound and quantified targets for addressing extreme poverty in its many dimensions – income poverty, hunger, disease, lack of adequate shelter, and exclusion – while promoting gender equality, education, and environmental sustainability. They are also basic human rights – the rights of each person on the planet to health, education, shelter, and security.⁴²

The United Nations Millennium Declaration,⁴³ adopted by 189 UN Member Nations, outlines the signatory countries' commitment to achieving eight Goals, which include: eradicating extreme hunger and poverty; achieving universal primary education; promoting gender equality and empowering women; reducing child mortality; improving maternal health; combatting HIV/AIDS, malaria and other diseases; ensuring environmental sustainability; developing a global partnership for development. The deadline for the attainment of the MDGs is set for 2015. Although some progress has been made, the risk of not fully meeting many of these targets is big. Estimates of how much more aid would be required to achieve them vary widely. The UN estimates that the annual funding needed is about 50 billion dollars. By contrast, another estimate puts the figure at 135 billions of total ODA in 2006, with a progressive increase up to 195 billions in 2015.⁴⁴ A first step in this direction would be that each donor country dedicated a minimum of 0.7% of GNI to development aid. Furthermore, devoting a consistent part of the CTT revenue to the MDGs project would undoubtedly increase its chance of success.

The second group of needs that the CTT revenues could address is the provision – or the preservation – of *global public goods*.⁴⁵ In the economic theory, public goods are characterised by two typical properties: (1) non-rivalry or non-congestion and (2) non-excludability in consumption. Non-rivalry or non-congestion implies that a public good can be consumed (used or enjoyed) by any individual without (significantly) diminishing the possibility of consumption for others. Non-excludability means that it is either very costly or technically impossible to exclude non-payers from consuming the public good. The opposite of a public good is a *public bad*, which is equally defined by non-rivalry and non-excludability. Examples of public bads are communicable diseases, organised crime and pollution. The provision of a public good can often be considered in terms of reducing or removing a public bad. Public goods can be classified according to their spatial dimension in local (e.g. streetlights), national (e.g. national defence),

⁴² *Millennium Project*, <http://www.unmillenniumproject.org/goals/index.htm>, July 2006.

⁴³ Resolution 55/2 adopted by the UN General Assembly on the 18th September 2000.

⁴⁴ Sachs (2005), *Investing in development, a practical plan to achieve the Millennium Development Goals*, UN Millennium Project, New York.

⁴⁵ For a detailed description of global public goods see Kaul, Grunberg and Stern (1999), *Defining Global Public Goods*, in I. Kaul, I. Grunberg and M. A. Stern (eds.), *Global Public Goods: international cooperation in the 21st Century*, Oxford University Press.

regional (e.g. environmental protection of the Baltic Sea) and global (e.g. the ozone layer). The provision of global public goods generates important externalities to the benefit of, in principle, all people around the world regardless of their individual contribution to the production of these goods. In the absence of a supranational enforcement power, this creates an incentive for the individual, or the individual state, to free-ride. As a result, investment in the provision of global public goods tends to be sub-optimal.

Examples of global public goods can be: stability of the international financial and monetary system, an open trading system, the protection of global environmental commons (e.g. climate, bio-diversity), communicable diseases control, knowledge creation and diffusion, international peacekeeping, the prevention of CFC emissions, limitation of carbon emissions. The UN estimates that satisfying the needs in global public goods would probably require a minimum of 20 billion dollars a year, four times the current spending level.⁴⁶ As an example, the fight against tuberculosis and malaria would cost around \$2 billion, and that against AIDS \$7-10 billion. The CTT revenue – managed by a supranational body – would therefore be ideal for addressing this shortage of funds.

3. From proposals to law: some practical examples

3.1 The French law introducing a tax on foreign exchange transactions

The Finance Act n° 3262, approved by the French National Assembly on the 19th November 2001, has a highly symbolic value. It was actually the first law in the world to introduce a Currency Transaction Tax in the national Tax Code. For this reason, it became both a sort of manifesto for CTT campaigners to show that the proposal was feasible, and a model, a source of inspiration for other similar legislation.

Firstly, it must be specified that the tax is not yet being levied because for this to happen it is preliminary required that all EU member states adopt a similar bill. This clause was introduced to show France's willingness to act not in isolation, but rather within the context of Europe. To stress this fact, the bill also hopes for a ruling on the matter by the EU Council of State, for example under the form of a EU directive. In this case, France would already be in compliance with EU law, while other states could copy or take inspiration from the French text. To sum up,

⁴⁶ *Zedillo Report, op. cit.*, p. 9.

it can be said that the aim – rather than to actually introduce a CTT in France – was mainly to set an example, to show to other EU members that such a proposal is viable.

As far as technical aspects of the law implementation are concerned, the text does not go into details. The tax devised is not a two-tier one, but there would be a single tax rate, with an upper limit of 0,1%. Transactions hit by the tax would be both cash and derivatives ones and the rate would be levied on the gross proceeds of the operation. However, exemptions are provided for: exports and imports of goods and services for cash, foreign direct investment operations and foreign currency transactions undertaken by persons with a value of less than 75,000 euros. It must be remarked that this limit is quite high compared to other proposals. Other exemptions are granted to the Bank of France – as manager of the nation's foreign exchange reserves – and to the Treasury. A potential loophole in the collection of the tax may result from the complete absence of any reference to the territorial application of the tax, i.e. what link between the financial operation and the French territory – more broadly, sphere of sovereignty – is required for the tax to be applied.

Quite a lot of attention is paid to estimates of the potential revenue of the tax. Calculations based on a Bank of France's study on the Paris exchange⁴⁷ show that the tax may yield up to 12.5 billion euros per year – assuming the maximum allowed rate of 0,1%. By contrast, nothing is said about the destination of this money. The only objective mentioned in the text is “the control of the volatility of international capital flows, which can have a destabilizing effect on the global financial system”. There is nothing about financing development, international cooperation or global public goods. It must consequently be deduced that the tax would be administrated as a source of revenue among others, without being devoted specifically to international purposes.

3.2. The Belgian law seeking to levy a tax on foreign currency exchange operations

General features of the bill

This paragraph will focus on the analysis of the Belgian legislation introducing a Currency Transaction Tax, firstly proposed on the 15th July 2003 and then adopted in July 2004.⁴⁸ Unlike the French law, this one refers to the “Spahn version” of the Tobin Tax, based on the two-tier

⁴⁷ Bank of France (2001), *Survey of Foreign Exchange Market and Derivatives Market Activity*.

⁴⁸ See Private members' bill “Seeking to levy a tax on foreign exchange operations, banknotes and coins” filed by MESSERS Dirk Van der Maelen and Geert Lambert on July 15, 2003 to the Chamber of the Representatives of Belgium.

system. Moreover, the legal framework is based on the 6th European Directive concerning VAT matters. Its entry into force is subordinated to the subsequent introduction of similar legislation in all the countries within the Eurozone.

Application field

The tax is applied to “exchange transactions, be they direct or indirect, involving cash or credit, bank money or not, in currency when they take place in Belgium” (art. 2). The most general definition of *currency exchange operations* is the one provided in art. 4: “[operations that] involve the exchange of currency in return for commission”. This is meant to include also the exchange operations involving the purchase of goods and services and those using financial instruments having the same effect as an exchange of currency – e.g. derivatives. To be liable to pay the tax, however, these operations must have another characteristic: they must have taken place in Belgium. This includes the following cases: a) if one of the parties or one of the intermediaries involved in the transaction is established in Belgium;⁴⁹ b) if the payment, the negotiation or the orders are done in Belgium; c) if one of the currencies exchanged constitutes legal tender in Belgium – i.e. if the transaction is effected in Euro – and only if the country in which the operation takes place does not already apply a similar legislation (art. 5).

Liability to pay the tax

Article 3 of the bill defines “whoever is involved, even occasionally in an independent way, in a taxable operation” as legally bound to pay the tax. From an economic point of view, each exchange transaction can be analyzed from two different perspectives, corresponding to those of the two parties taking part in it. For example, a conversion of euros into dollars can be considered from the point of view of the operator selling euros for dollars and in parallel from that of the one selling dollars for euros. Both parties are therefore liable to tax, and both should in principle pay on the total amount of foreign exchange involved. Since the exchange transaction is therefore doubly taxed, the total amount is divided by two. Thus, each party has to pay half of the tax which falls due according to the tax rate applied.

Furthermore, in order to avoid easy tax evasion or fraud, the text introduces the notion of *fiscal unity*, taken by the EC sixth Directive concerning VAT. This means that companies or

⁴⁹ A subject liable to tax is established in Belgium when his/her/its headquarters or the effective management of his/her/its activity, or in the absence of such headquarters or of such management, a steady establishment is situated in Belgium. In case there is no such establishment he/she/it should have his/her/its domicile or his/her/its place of residence in Belgium.

independent persons from a legal point of view, but who have financial, economic or organizational ties, may be considered to be a single taxpayer. The provision is meant to include subsidiaries or entities of companies and associations established in Belgium which are set up in tax havens – or in States where the tax is not applicable. When such subsidiaries (or other similar juridical persons) are parties or intermediaries in the exchange of currencies, they are considered as being liable to pay the tax (art. 3§2).

Tax rate

Article 8 fixes the rates according to which the tax will be levied. As already explained in paragraph 1.1, the Spahn version of the Tobin tax is based on two different rates. The normal one stands at 0,2‰ (0,02%), so as to minimize the inevitable, resulting distortions in the market's price-setting mechanisms. The second higher tax rate is applied whenever the effective exchange rate goes beyond an agreed band. This will be determined on the basis of a progressive average of the currency exchange rate in the last twenty days. Around this central value, a fluctuation margin has to be set by the executive in order to define the width of the band. However the application of the exchange surcharge does not automatically follow the violation of the target zone, but requires a decision by the Council of Ministers of the EC on the matter. The procedure is the one already followed in the past for the devaluation of EC member states' currencies, and has been devised to comply with article 59 of the EC Treaty.⁵⁰ Nevertheless this aspect is one of the most controversial of the bill and can be subject to criticism. In fact, it seems to prove an underlying mistaken representation of the relationship between Community and national law.⁵¹ The former cannot be subject to a Member State's legislation, since it has its own procedures and sources which derive from treaties between Member States, not from their national law. In this sense, even if all the Members States adopted a similar legislation, the Council of Ministers would not be bound to follow their procedures with regard to the application of the exchange surcharge. To achieve this result, either a European law, e.g. a regulation or a directive, would have to be approved by the EC itself or a new treaty would have to be ratified between all the member states concerning the application of the exchange

⁵⁰ “Where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the ECB, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary”.

⁵¹ ECB (2004), *Opinion of the European Central Bank of 4 November 2004 at the request of the Belgian Ministry of Finance on a draft law introducing a tax on exchange operations involving foreign exchange, banknotes and currency*, (CON/2004/34), § 17, 18, 20.

surcharge or any other aspect of the introduction of the CTT which involved the EC. Indeed, this problem will return with regard to the management of the sums collected with the CTT, analyzed in the following paragraph.

Use of tax revenues

Article 5§1 of the bill states that “the product of the tax, after deduction of a percentage that is fixed by the King, is totally paid into a fund, managed by the European Community, and it will be used for purposes of development cooperation, for the promotion of social and ecological justice and the preservation and the protection of international public property”. Despite the good intentions underlying the article – the management of these sums by the EC rather than by the single state should guarantee more accountability and transparency – from a legal point of view it is not correctly formulated. A legislator of an individual Member State cannot attribute the management of a fund established at national level to the EC. The creation of new Community tasks cannot be set by national legislation, for the very same reasons stated in the preceding paragraph. Again, the same result could be achieved only by the introduction of the tax at Community level.

Final remarks

Some interesting conclusions can be drawn from the discussion of the Belgian bill introducing a CTT. The first is that the implementation of this measure might be technically feasible, though with some inevitable difficulties. A tax rate so low as the one proposed here should reassure those opposing the provision on purely economic grounds. On the other hand, the biggest problems seem to lie in the juridic aspects. As underlined in the previous paragraphs, there are several incompatibilities between the Belgian bill and the EC Treaty. Furthermore, these cannot be solved by simply modifying the national law. In fact, as the process of economic integration between Member States went on, up to the adoption of a single currency, it was inevitable that national governments gave up some essential powers, which had to be centralized and were gradually delegated to the Community. The biggest examples are perhaps the exchange-rate and interest-rate policies in the Eurozone, which at present are exclusive Community competences. Unfortunately, the exchange rate is precisely the domain which the Currency Transaction Tax wants to regulate. Another probable area of conflict concerns the free movement of capital and payments between Member States, and between Member States and third countries, which is a centerpiece of the EU common market. Since not all Member States

have adopted the Euro, the CTT would limit this freedom, reserving a less favorable treatment to transactions involving the currency of a non-Euro Area Member State compared to the same kind of transaction in the Eurozone.

For all the above-mentioned reasons, it seems very difficult that a CTT can ever be applied by a single EC Member State. The progressive reduction of the national law's scope compared to that of the Community law does not leave enough room for national governments to intervene on these subjects. Therefore, the only plausible solution is the introduction of a legislation similar to the Belgian one, not at national but at Community level, as hypothesized in a previous paragraph. The best instrument would probably be an EU directive, similar to the sixth directive relative to VAT. This would bind EC Member States to the introduction of a CTT but leave the details of implementation, as well as the administration, to each state.

Exemptions could be made not to penalize non-Euro area Member States compared to Euro area ones; for example not levying the tax on transactions involving the exchange of Euros for the currency of a non-Euro area Member State.

To conclude, the EC undoubtedly has the juridic means to introduce such a measure, which falls under its rather than under national governments' competences. Whether it has the political capital and the will to do so, overcoming probable oppositions from some Member States and pressure groups, is another matter. The crisis subsequent to the constitutional Treaty's rejection by French and Dutch voters in 2004 led to a "reflection pause" which is far from terminated. Among other things, the no-vote was motivated by the voters' perception that the EC was sliding towards a ultra-liberist path. In this sense, committing to an objective not of deregulation, but of regulating markets, such as the CTT is, may demonstrate to European citizens that their message has been acknowledged and the EU is changing direction.

Anyway, it must be remembered that introducing the CTT at a regional level, though surely better than its application by a single country, remains a second best solution compared to the implementation at the global level. A better option for the EC to show that it has overcome its crisis could be to start and take the lead of a process aiming at the creation of an international organization for the administration of a CTT. This is what will be discussed in the following paragraph.

3.3. A draft "Treaty on Global Currency Transactions Tax"

This paragraph will be devoted to the analysis of the introduction of a Currency Transaction

Tax at the international level. In particular, it will refer to the detailed and comprehensive draft “Treaty on Global CTT” devised by Patomäki and Denys.⁵²

Technical aspects of the tax

From a technical point of view, the Currency Transaction Tax instituted by the “Treaty on Global Currency Transactions Tax” does not differ substantially from other proposals already analyzed – e.g. the Belgian law. The States ratifying the treaty commit themselves to introducing in their national legislations a “Currency Exchange Transaction Tax” according to the guidelines contained in the treaty itself. The system proposed is the well-known two-tier one, as devised by Spahn. One step further has been made with reference to defining the territorial application of the tax. A transaction can be taxed if at least one among the transferor, the transferee or the intermediary has established his business in the territory of one of the Contracting States. Even if none of the above-mentioned conditions are met, it is sufficient that either the place of the payment or settlement, or the place of dealing or trading, or the place of booking, are situated within the territory of one of the Contracting States to make the transaction subject to the tax (art. 9). This definition is by far the clearest and most complete of all the proposals here taken into account and should facilitate the actual administration of the tax.

For the very same reason of simplification, the responsibility to pay tax shall in the first place lay with the professional financial intermediaries – banks and other financial actors. Only if none of the parties involved in the transaction has called upon an intermediary, the tax becomes liable to the parties themselves. By doing so, there should be an important reduction in the number of tax payers, thus facilitating the collection and discouraging evasion. The CTT will be payable to national taxation authorities, which will cooperate with central banks and have access to the information of institutions such as the Continuous Link Settlement Bank. States also agree to allow the sharing of information regarding their forex market activities and taxation.

As far as taxable transactions are concerned, these are defined as “any currency exchange transactions, whether direct or indirect, on cash or forward, whether or not by giro” (art. 5). Transactions in financial instruments or derivatives, as well as agreed mutual exchange of assets substituting for exchanges of legal tender are included in the tax base. By contrast, exceptions are drawn for “collection items” – i.e. gold, silver or other metal coins or bank notes which are not normally used as legal tender or are of numismatic interest. Another exemption is granted to

⁵² Patomäki and Denys (2002), *Draft Treaty on Global Currency Transaction Tax*, Helsinki, The Network Institute for Global Democratisation.

taxable persons with an annual taxable amount of less than 10,000 Euros – or its equivalent in national currency (art. 15§7). As in the Belgian case, the amount on which the tax is applied is the gross amount of the transaction, including incidental expenses and those covered by a separate agreement.

Another interesting feature is the application of an additional tax of 2% on domestic currency lending to the non-Members (art. 3§3). The measure can be considered a “carrot and stick” approach in order to persuade especially developing countries to join the treaty. As a result, developed Contracting States will prefer to lend to developing countries which are part of the treaty as well, rather than to non-Members, not to have to pay the 2% levy. Provided that a great part of donor countries ratify the treaty, this clause would create a huge incentive for aid recipients to sign it. Moreover, a penalty rate of 25% is set on any capital outflows or inflows to and from tax havens (art. 3§4).

The institution of a “Currency Transaction Tax Organization”

The most distinguishing feature of Denys and Patomäki's proposal is the establishment of a Currency Transaction Tax Organization (CTTO) among the Contracting Parts of the Treaty. This new international body would be aimed at monitoring and giving guidance on the application of the global CTT described in the previous pages. Furthermore it would be open to new forms of democratic participation to an extent yet to be seen in other international organizations. Part IV of the Treaty describes in detail the structure of the Organization, which resembles the tripartite one typical of international bodies. Its main organs are:

- The *Council of States*, comprised of the representative of the Contracting States; its functions include preparing the budget of the CTTO, clarifying the interpretation and application of the Treaty, intervening in case of disputes between Contracting States. Decisions shall be taken by consensus and, when it can not be reached, by a two-thirds majority on matters of substance or by a simple majority of present and voting members on other matters. Votes are assigned to each State according to its population: one vote if the country has less than 10 million people, two votes if more than 10 but less than 100 million people and three votes if more than 100 million people.
- The *advisory Committee*, performing the functions of a panel of experts who shall serve in a personal capacity. It can examine questions – raised by a Contracting State or by one fifth of the members of the Committee – which concern the application of the Treaty provisions. Its members will be appointed by the Democratic Assembly.

- The *permanent Secretariat*, which carries out the administrative functions. It is accountable to the Council and its main responsibilities include: implementing the decisions of the Council and the Assembly, monitoring the States' application of the Treaty and referring them to the Council and the Assembly in case of breaches, managing and keeping account of the proceeds of the CTT. Moreover it arranges the meetings of the CTTO and produces a Bi-Annual Report that has to be approved by the Assembly.
- The *General Democratic Assembly*, which has autonomous powers and holds the Council accountable. It is in charge of determining the budget, as prepared by the Council and setting motions on any topic related to the CTT or the use of its revenues. The most interesting aspect of this body is its composition. The Assembly will be comprised of representatives not only from governments, but also from democratically elected national parliaments. Furthermore, the Assembly will elect a number of members representing the civil society, coming from an ad-hoc established “Coalition of Non-Governmental Organizations at the CTTO”.

The difference between this composition and the traditional standard for international bodies has to be stressed. Here we actually reach the highest level of democratic participation ever seen in an international organization. This evolution acknowledges a long-standing demand coming from the civil society itself, to hold national governments more accountable at the international level. It is often remarked that in these seats the governments tend to pursue their own interests rather than the actual will of their people. An effective solution to this problem may be to allow the civil society – represented by NGOs – to join these bodies.

Managing the CTT revenues

The CTT will be administrated and collected on a national basis by national taxation authorities. However, part of the tax proceedings will be transferred by each State to the CTTO. The proportion hypothesized in the draft Treaty is developed countries contributing 80% and developing countries contributing 30% of revenue from the CTT.⁵³ Governments are free to use the remaining share for national use, thus enhancing their freedom of manoeuvre and autonomy in economic policy. The agreed part shall be paid to the *Global Fund* – as established under article

⁵³ The distinction between “developed” and “developing” countries is made on the basis of membership of the OECD. Members – Mexico and South Korea excluded – are considered “developed countries” while non-Members – including Mexico and South Korea – are designed as “developing” ones.

17 of the Treaty. This fund, managed by the Council under supervision of the Democratic Assembly, will be used to finance global projects of public utility. Moreover, a part of its resources will be devoted to the *Global Intervention Fund*, which may support a currency which is depreciating too fast by buying that currency on the markets in sufficient volumes. It is difficult, however, to see the utility of this second fund: currencies should be already protected from speculative attacks by the two-tier tax system; furthermore the efficiency and efficacy of this kind of currency intervention is questioned by many economists and by everyday evidence.⁵⁴

Phases of implementation of the Treaty

After this exposition, it must be remembered that the Treaty is only a draft proposal devised by two scholars and it is far from being implemented. What steps should be made in order to make it happen? Often, even the most difficult campaigns can conclude with a success once they have gained enough momentum and attention to the eyes of the public opinion.⁵⁵ This requires a strong initiative from the civil society, which has in turn to be supported by one or more national governments, that lead the diplomatic efforts towards the realization of an International Conference to discuss on the matter. What I hypothesized in the final lines of paragraph 3.2. was precisely the EU taking a leading role among the international community to convene a summit to adopt a Treaty on Global Currency Transaction Tax.⁵⁶

Once the conference takes place, representatives of all the national governments willing to participate discuss and eventually reach a consensus on a final text, which may differ substantially from the one analyzed here. For example, it is difficult that governments would accept the presence of civil society representatives at the Democratic Assembly, though the possibility can not be ruled out. When a final document has been agreed on and signed by the Plenipotentiaries participating to the summit, the Treaty is deposited with the Secretary-General of the United Nations. From that moment on, the treaty is open for signature for the States which have not participated in the diplomatic conference, and for ratification for the States that have already signed it. Ratification is the formal act by which the State binds itself to what is written in the Treaty, becoming part of it.

⁵⁴ See for example "The Economist", *Meddling in the currency market*, 18th November 1999.

⁵⁵ As a paradigmatic example, I here recall the campaign for the abolition and ban of antipersonnel landmines, conducted by Jodie Williams (Nobel laureate for peace in 1997) and the network ICBL – International Campaign to Ban Landmines. The campaign was launched in October 1992 and in September 1997 achieved its goal of an international treaty banning antipersonnel landmines, thanks to a strategic partnership between NGOs and governments, particularly the Canadian one.

⁵⁶ See p. 43-44.

Article 27§1 requires other two conditions for the Treaty to enter into force. The first is that at least thirty States have ratified it. The second is that the ratifying States must account for at least 20% of the global currency markets.⁵⁷ Article 26 provides for the creation of a “Preparatory Group” of signatory States until the Treaty enters into force. Its mission should be to pave the way for entry into force of the Treaty, for example preparing for the establishment of the CTTO, lobbying other States to join, etc.

Eventually, once the above-mentioned conditions are met, the Treaty provides for other two different phases of entry into force. The first, starting as soon as article 27 conditions are fulfilled, includes the introduction of the CTT, the establishment of the CTTO – which will be independent of any existing international organizations – , the location of its headquarters, etc. The Organization shall move into the second phase when it includes among its members countries covering at least 90% of forex transactions. Then, a Review Conference must be convened to consider the necessary amendments to the Treaty and whether the CTTO should pursue more intensive partnerships with pre-existing International Organizations – as the IMF or the WB – and/or seek recognition by the United Nations, e.g. as a subsidiary body or as a specialized institute.

Conclusion

It is very difficult to summarize and to draw conclusions about a thirty odd-year-old debate. From an economic point of view, during all these years orthodox economists never agreed neither with the diagnosis – the forex market is too volatile – nor with the therapy – the market must be regulated with a transaction tax – proposed by Tobin and subsequently by his followers. Central bankers in particular were among those criticizing more fiercely the two above-mentioned theses.

However, orthodox economy has not always provided the right answers to every problem. For example, J. M. Keynes could not easily be defined as an orthodox economist. Yet, his theories inspired policies that were capable of overcoming the greatest crisis in the history of capitalism: The Great Depression. By contrast, policies in line with the economic orthodoxy of that time were indeed aggravating the crisis itself. Later on, Keynesian policies were at the basis

⁵⁷ It is to be recalled that these threshold are those drafted by Patomäki and Levy and Contracting States may agree differently. However, it is common for international treaties to require not only a certain number of ratifications to enter into force but also that ratifying States represent a certain percentage of what the treaty wants to regulate. As an example see the *Kyoto Protocol* to the United Nations Framework Convention on Climate Change (UNFCCC).

of “the golden age” of capitalism, during the Fifties and the Sixties.

One might argue that today the world is not facing a crisis as it was during the Thirties. On the contrary, the world economy is buoyant, global output is rising faster than expected, etc. So why should we worry and raise the burden of market regulation with just another tax? However, deepening the analysis, the outlook becomes less rosy. Actually, the process of globalization and global economic integration rests on bases not so solid as it could seem at first glance. Since the Fifties, this process has been based on a gradual liberalization of world trade, lowering tariffs and other trade barriers. In this sense a very bad signal is represented by a most probable failure in the current round of trade talks within the World Trade Organisation, the Doha Round. The consequences of this failure might be far-reaching and they can not be dismissed saying that “it's just trade”. This round of talks is also known as the “Development Round”, since one of its main goals was to give greater trade opportunities for developing countries. These in turn had to be granted through significant cuts in farm tariffs and subsidies by rich countries. The collapse of the negotiations was the result of two different factors. On one hand, short-sighted national interests and lobbies won over more forward-looking, general ones; on the other hand, rich countries – especially the US and the EU – did not assume the responsibility for the promises they had committed themselves to, first of all to share more equally the benefits of trade liberalization. Leaving aside what the causes may be, the result is that the progress towards ever-greater economic integration might slow down, or even come to a halt, with consequences that are difficult to imagine.

Today, every declaration of principles, every conference or summit, opens with the statement that globalization is profoundly unequal and that these inequalities need to be addressed. The Currency Transaction Tax may prove to be an answer to this problem, in that it could provide resources to tackle poverty together with its environmental, social, cultural consequences. It may not be the only possible solution nor the best one. More plausibly it could be seen as part of a package of reforms, together with other global taxes (e.g. a carbon tax), with new or reformed multilateral bodies that would ensure greater voice to poor countries, and with other proposals.

The diagnosis is now widely accepted: something ought to be done to correct these ever-growing injustices. It is high time to work together towards finding the solutions and multilateralism is the only possible path to confront with these global issues. Tackling them will require political leadership, a vision of a different, better future and most of all a great deal of courage. However, it should be borne in mind that the consequences of inaction might be even worse than those of a wrong action.

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