Work Group on a Solidarity Socio-Economy – Alliance 21
Preparatory Meeting for Launching of the Workshop on International Regulations within the context of a Solidarity Socio-Economy in an era of Neo-liberal Globalization
Tokyo
October 9-11, 2003

Costs of currency speculation; the evolving Tobin Tax; the dynamics of today's campaign

David Hillman, Tobin Tax Network Coordinator (UK)

Introduction
My presentation is about the currency transaction tax (CTT) – the Tobin Tax. I will for the most part take a campaign perspective, although for a time take a more academic line referring to the very recent work of Japanese economist, Machiko Nissanke.

My goal is to touch on the different aspects of the Tobin Tax:
The various constituencies who have been affected by currency speculation
How the Tobin Tax campaign is evolving and
where the campaign can travel to now.

I would like to emphasize from the start how potent the Tobin Tax issue is as a campaign vehicle and make clear its potential makes it is as relevant now as it has ever been. I believe my presentation will show that the Tobin Tax campaign is not tired or past its sell-by date (as some critics may want us to believe). It is, instead, very much on its way to maturity and may have a critical role to play in moving our wider 'solidarity' agenda forward.

Section 1: Costs of currency speculation
(based on the 'Costing the Casino' report written by the UK charity, War on Want, available at: http://www.waronwant.org/?lid=1443).

Firstly, let us remind ourselves where the Tobin Tax campaign came from by looking at who has been affected by the 'Money Trade' – **the cost to people of currency speculation and volatility.**

Most of the financial collapses of the last ten years were triggered, and their effects intensified, by speculation on currency markets, which turned localized shocks to investor confidence into major economic crises. The foreign exchange markets have registered an astronomical rate of growth in the last three decades. In the early 1970s, $18 billion dollars a day was traded; in today's currency market trading is of the order of 1,300 billion dollars a day – 70 times greater.

While this volatility on currency markets enables banks and investors to make multi-million dollar profits, it has led to extreme social distress in those countries, which have found themselves the victims of the devastatingly powerful financial forces wielded by a comparatively small number of particularly powerful financial players, such as Citigroup, Deutsche Bank, Goldman Sachs and J.P. Morgan.

As is well-recorded the South East Asian financial crisis of 1997/1998 **translated into economic collapse. Growth rates, which had previously averaged 7% p.a. across the region, dropped substantially in 1998. In Thailand, growth fell from 5.5% in 1996 to minus 10.8% in 1998. In Indonesia the corresponding swing is from 8% growth in 1996 to minus 13.2% in 1998.**

In 1998, **unemployment** rates quadrupled in Thailand and tripled in Korea. In Korea between October 1997 and July 1998 1.2 million people lost their jobs: i.e. about one in 20 workers. Six million people became unemployed in Indonesia in the second half of 1997. The job insecurity that resulted from the crisis led to an erosion of **workers' rights** in the countries affected, particularly in Thailand.

Virtually all groups were affected, although the poor and other vulnerable groups such as women and children disproportionately so, since the poor spend a larger percentage of their income on basic goods, and therefore are harder hit by price increases and falling wages.

Rising **poverty caused parents to withdraw their children from school** in order to send them out to work, compromising their future. It may never be possible to recover these students to the educational system, causing a permanent loss to these societies.

Children are also likely to have been most severely affected by **cuts in health spending**: a study concerning the effects of the Latin American economic crisis on the health sector found that child malnutrition and infant mortality increased more appreciably than mortality among the population at large.[1]

There were marked **increases in ill health**, partly because of a reduction in employer-provided health facilities, and the escalating price of imported drugs, due to currency depreciation.

The crisis is likely also to have had a **negative environmental impact**, in leading to a concentration on export-led growth to pay off the debts incurred in rescue packages, and increased foreign investment in logging, mining and oil exploration. Government budgets for environmental protection declined in both Korea and Malaysia.[2]

As with most developing country problems, women were disproportionately affected**. Women were concentrated in the most precarious forms of low-skilled wage employment in the textiles and garments sector, where they customarily make up a large percentage of the workforce and were hit hard by the recession where wages and entitlements were cut back, and significant unemployment resulted.**

---

[1] UNESCAP, p. 20.
[2] Duncan Green, p. 18.

Women are also often the victims of physical violence stemming from heightened social conflict. An increased incidence of domestic violence was reported in all the countries affected. The economic crisis made worse gender inequalities that had appeared to be diminishing during the preceding era of prosperity.

The Global Impact
The effects of the crisis were not confined to Asia, but also spread to other emerging markets, particularly Argentina, Brazil, South Africa, Turkey and Russia. There was a general fall in investor confidence in emerging markets, leading to capital outflows, devaluation and stock market collapses.

The International Labour Organisation (ILO) estimated that the number of unemployed around the world rose by 10 million directly as a result of the Asian crisis.

Conclusion
To conclude this section, it is often only when we hear a human story, a personal tragedy, learn of real suffering that the true cost of events sinks in. To quote from a recent article:
In Northern Thailand in 1997 a garment factory closed. A mother found herself unable to support her 11-year old daughter. Reluctantly she sent her to work as a hotel maid in Bangkok. But the daughter was escorted instead to a nightclub in the beach resort of Pattaya. The owner – a pimp - forced her into prostitution. She serviced an average of twenty men each night and was chained to the bed to prevent her escaping during the day.
This didn't happen to just one girl. In 1998 the number of child prostitutes in Thailand suddenly jumped by 20% - nearly 7,000 children. Why? True, the economy of Thailand was already entering recession but the aggressive efforts of currency speculators to turn a fast profit from the countries' difficulties was like pouring petrol onto the flames. Their activities forced a sudden and catastrophic collapse in the value of the Thai currency, the baht. The government, unable to service its own foreign debts, was forced to slash public spending. Unemployment quadrupled. The price of basic foods shot up. And the garment firm that employed the mother in this tale went bankrupt.
In contrast the HSBC Annual Report for 1998 put it like this:
" Dealing profits increased in 1998 as the Asian currency turmoil continued through the first half of 1998 and wide margins and high volumes in customer driven business continued to underpin foreign exchange revenues".

Into this charged atmosphere a relatively obscure and almost entirely forgotten idea by an American economist, James Tobin, was resurrected and this idea was for a Currency Transactions Tax.

And as the campaign for it evolved it gave rise to groups such as ATTAC that in a few short years have grown to a movement with groups in 50 countries, especially France, Germany, Sweden, Italy and some South American countries.

And ATTAC has helped to shape a new phenomenon 'Social Forums' – acting as beacons shining a light towards ANOTHER WORLD BEING POSSIBLE, one where PEOPLE COME BEFORE PROFIT.

Section 2: The evolving Tobin Tax
To describe today's Tobin Tax I am keen to bring to your attention the recent paper by Japanese economist, Machiko Nissanke, of the School of Oriental and African Studies, University of London, written at the request of the UN General Assembly as part of a research project to investigate "innovative sources of development finance". (Extracts of her paper: 'REVENUE POTENTIAL OF THE TOBIN TAX FOR DEVELOPMENT FINANCE: A CRITICAL APPRAISAL' are reproduced here by kind permission of the author. The paper is available in full on: http://www.wider.unu.edu/conference/conference-2003-3/conference-2003-3-papers/Nissanke-2308.pdf).

Background
Tobin proposed a currency transaction tax first at the Janeway Lectures delivered at Princeton in 1972 and again at the presidential address to the Eastern Economic Association in 1977. The currency transaction tax, widely known as the Tobin Tax, was initially proposed for enhancing the effectiveness of national macroeconomic policy and the operation of the international monetary system by reducing short-term speculative currency flows.

Tobin himself conceded that his proposal did not receive serious consideration from fellow academics or policy-makers. However, in contrast to the disappointing response to Tobin's proposal in the 1970s, followed by the long silence over the subject in the 1980s, there has been a sudden surge of interest in the Tobin Tax since the early 1990s. This reflects the growing recognition that there is an urgent need for creating a new international financial architecture governing cross-border capital flows in face of the repeated severe financial collapses. These include self-fulfilling currency crises in a large number of European countries in the exchange rate mechanism and in emerging market economies such as South East Asia as discussed in section one.

However, especially due the UN Millennium Development Goals (MDGs) and the 'financing for development' agenda reflected in the Monterrey process, it is important to note the recent surge of interest in the Tobin Tax is also explained by its potential for generating substantial revenues. It has been argued widely that revenues from CTTs have the potential to serve as an important source of finance for 'global public goods'. The case is made all the stronger by the recognition that due to the current rate of extremely slow progress on 'debt cancellation, 'improvements to the terms of trade' and 'increases in official aid' (to 0.7% of GDP in OECD countries) that the extra $50 billion required to pay for the MDGs simply cannot be found without finding (as yet untapped) income streams.

The Tobin Tax – historically was according to Tobin's own words "throwing sand in the wheels' of currency speculation. Tobin suggested that the CTT could make short-term trades more costly and by doing so, it would increase the maturity structure of international capital flows. Filtering transactions by the maturity on the understanding that speculators would have shorter horizons and holding periods, the tax (according to Tobin) is set to "make exchange rates reflect to a larger degree long-run fundamentals relative to short-range expectations and risks".

Today's Tobin Tax
Tobin wrote about a CTT in the 1970ies when the market was worth a fraction of its current value (it has grown from $18 billion to more than £1,200 billion a day). It is of such a size now that specifically taxing this market is now an option for financing international development. However for this to be viable the market would need to remain, for the most part, intact. A key question, therefore, is what tax rate the market can stand and at the same time produce a good revenue? Machiko Nissanke argues that the liquidity-efficiency dimension has a critical bearing on the question about the optimal (or permissible) range of the Tobin Tax rate and that this rate cannot be set above a certain threshold level to undermine liquidity and market efficiency. This, in turn, suggests a much lower rate than has emerged previously from the body of literature on the subject.

However, **a low tax rate would certainly not be effective in countering large-scale speculative attacks** as observed in the recent currency crises[3]. And a high rate tax would create severe liquidity problems for normal market operations. The two positions are reconciled by **a 'variable currency tax', rather than a time-invariant uniform tax.**

This proposition is directly addressed in the two-tier tax system proposed by Paul Bernd Spahn (1996, 2002). The two-tier structure embedded in Spahn's proposal 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". Under this system, "an exchange rate would be allowed to move freely within a band, but overshooting the band result in a tax on the discrepancy between the market exchange rate and the closest margin of the band", while the low transaction tax is levied on a continual basis, raising substantial and stable revenues. This would provide monetary authorities with a breathing space for orderly re-alignments of exchange rates.

Indeed, once such a system is seen to be operating efficiently with credibility, a *threat* of the surcharge levy alone may be sufficient to keep exchange rates within a target zone. Thus, interestingly, this scheme could be deemed to be successful, when the exchange surcharge is never levied.

Technical and political considerations and overall assessment

The CTT's **technical feasibility** is now widely accepted even by former critics due to the electronic nature of the market and the idea of taxing currency transactions at the point of settlement as proposed by Rodney Schmidt. The considerably more formidable obstacle is political will.

Foreseeing a fierce opposition from the US administration and Congress, Spahn (2002) proposes a **regional solution** reckoning with the fact that the Tobin Tax cannot be introduced universally or multilaterally in the first instance. He advances the concept of a politically feasible Tobin Tax implemented unilaterally by a group of countries such as the European Union in cooperation with the UK and Switzerland.

Nissanke's conclusion re income generation (based on calculations by Frankel and Spahn) estimates that a CTT at 0.02 % (two one hundredths of 1%) applied to wholesale transactions would generate annual revenue of about US$ 30-35 billions annually, while a CTT at 0.01 % (a hundredth of 1%) would produce US$ 17-19 billions.

Nissanke concludes that currency transactions taxes should be implemented in a cautious manner, starting with a very low tax rate. This is deemed necessary in light of recent structural changes in foreign exchange markets as well as considerations of market efficiency, liquidity, and technical and political feasibility. Introduction at a low rate could curtail the potential for leakages from CTT such as might result from asset substitution, market migration, or tax evasion.

---

[3] *Currency crises have increasingly become "self-fulfilling" in character where substantial financial gains are assured for speculators. Speculation in itself creates objective economic conditions that make devaluation likely. In fact, the expectations of speculators regarding the behaviour of governments in a crisis situation can generate the crisis. Under such conditions, a regime that could have been viable in terms of economic fundamentals experiences a collapse. In effect, crises are not so much precipitated by the actual mechanisms of the economy, but rather by the speculators' expectations of the choices that a government would make in a crisis situation. Thus, mechanisms of self-fulfilling crises work through market expectations. Under crisis conditions, an issue at stake is not merely whether speculators increase exchange rate volatility, but also whether they generate and exacerbate exchange rate 'misalignments' in terms of fundamentals.*

Certainly, the tax that could avert self-fulfilling crises has to be set at a much higher rate than one set to derive income for international development finance.

An Important Addition – opportunity cost and the double dividend

In her paper Machiko Nissanke also points out that global official foreign exchange reserves (which have been steadily increasing since the European exchange rate mechanism crises in 1992) are merely equal to 1.7 days of global currency transactions. This reveals the meagre capacity of monetary authorities to intervene in foreign exchange markets in face of speculative attacks on their currencies.

Monetary authorities have been trying to improve their defense capacity by raising official reserve holdings from 25 % of global exports in 1992 to 33 % in 2001. Developing countries, which are more likely to face currency crises, are forced to hold larger reserves in relation to the size of their economies at very high opportunity costs.

And it is the point of opportunity costs I wish to dwell upon to conclude this section for it points to the true worth of the Tobin Tax being far higher than the revenue it may bring in. For the cost to developing countries of not having the circuit-breaker higher rate Tobin Tax is that they instead have to hold huge volumes of unproductive foreign exchange reserves in case their currency is subject to attack.

The opportunity cost to poorer countries is severe because the reserves are badly needed for investment in infrastructure and people. In 2001, global official foreign exchange reserves were $2,039 billion. If a more stable currencies system existed, and if as a result between 2% and 5% of these reserves could be freed up, potentially amounts between $40 and $100 billion would become available.

Clearly, this is just an indicative calculation, and I am not aware of detailed academic work devoted to this area. However, it allows our thinking to shift to a new way of calculating the value of the Tobin Tax not just based on revenue. It points to the possibility of creating a headline figure for the net benefit of the Tobin Tax as a combination of revenue, which may be smaller than proponents first projected at between $17 - $35 billion, but with these figures being very significantly augmented if even a small proportion of foreign exchange reserves could be freed up, due to the new-found stability derived from the second tier of a two-tier Tobin Tax. This double dividend is an important new factor in the life of the evolving Tobin Tax.

Section 3: The dynamics of today's campaign
In part 1 of this presentation I review the grave, often hidden, human costs of an unregulated currency market. In the second part, I refer to Machiko Nissanke's paper (that I recommend you read in full), which I believe to be very important because it gives an academic backbone to where the CTT campaign has evolved to (certainly in the UK), namely: to focus on 'Financing for Development'. But now we are moving into the campaign section of the presentation I will make the point about the revenue potential of the Tobin Tax in a different way.

Let us consider the **sheer size of the currencies' market**. It's worth 1.3 trillion dollars a day, that's 1,300 billion dollars a day – these high numbers can be quite confusing so let me attempt to illustrate the size of the market. Let's imagine what a million dollars would look like – it would be a pile of £100 bills, which would be about my height. So how high would be a pile of $100 bills worth $1 trillion or 1,000 billion dollars? It would be one thousand miles high – reaching from the ground and into space. But that's just *one day's* trading! What about *one year's* trading? There are 250 trading days in a year. So the pile of $100 bills would extend for 250,000 miles – does anyone happen to know what is 250,000 miles away from here? The MOON ! So the size of this market is equivalent to a pile of $100 bills that stretches from the surface of the earth to the surface of the moon! This is over 50 times more than the entire trade in all goods and services like food, housing and transport. At it's simplest, today's Tobin Tax is giving a tiny slice of that enormous pile of money to the world's poorest people; or put another way, having those that are the greatest beneficiaries of globalisation give something back to those who are the least likely to see any of its benefits.

But why this change of emphasis towards the 'income generation' dimension of the Tobin Tax? Why this repositioning?
It is a response to a new political climate in which the UN Millennium Development Goals (MDGs) are increasingly becoming an important factor. This is evidenced, in fact, by Machiko Nissanke's paper being commissioned by the United Nations under a brief to find innovative ways for these Goals to be funded.

Although it is clear different countries have responded to the challenge of halving world poverty by the year 2015 in different ways (some more enthusiastically than others), there has been an almost radical response from the UK Finance Minister, Gordon Brown. His department, the Treasury, have openly acknowledged that the MDGs cannot be paid for unless an extra $50 billion each year is found. They have said new income streams need to be put into place and Gordon Brown has stated he is "open-minded" to innovative ways of financing international development including the Tobin Tax. But further than this the Treasury have come up with their own scheme to do this called the International Financing Facility (IFF). I will not detail exactly how it works here but suffice it to say the UK government have being lobbying the G8 (at the Evian summit) to adopt the IFF so that an extra $50 billion per year can be raised to pay for the MDGs. (For more information see the Tobin Tax Network position paper on the IFF at www.waronwant.org/?lid=5881).

The post-summit 'Evian Communiqué' speaks of the IFF and tasking the G7 Finance Ministers to take the initiative further. Why this is important is that essentially the UK Government is doing - at one level - what we would want to do as a campaign: convince the richest nations in the world that the MDGs are worth going for, that they need to be financed to the tune of an extra $50 billion per year and (with the target date being 2015) the money needs to be found now. It has led to the Tobin Tax Network recently meeting with the Treasury, in a constructive engagement, looking at the overall goal of how to fund the MDGs.

However, it is important to see the focussing on 'income generation' as a change of emphasis to suit new and evolving circumstances and of more relevance in relation to campaigns in certain countries as opposed to others. Undoubtedly, for some countries, especially middle-income ones, the more persuasive Tobin Tax argument likes with the circuit breaker component of the two-tier tax with its enormous benefit of bringing stability and the potential for freeing up foreign exchange reserves that could be even more beneficial than Tobin Tax revenue.

But how do we bring all the strands so far touched upon in this presentation together to drive forward a 'solidarity' agenda?
To make real progress the CTT campaign needs to be internationalised, similarly to the landmines and debt campaigns before it. The campaign to ban landmines can teach us some valuable lessons. Namely, certain

countries taking the lead can make a critical difference. With the landmines campaign Canada took the lead in the Ottawa Process that led to the majority of the world's countries banning manufacture, trade and military use of the weapon.

The Tobin Tax has different dimensions to its proposition: income generation and stability. Accordingly certain countries will be more interested in one aspect over another. However, we can roughly group them as follows:

1) Rich countries – G7/OECD
The UK and France have expressed (what appears to be) genuine interest in achieving the Millennium Development Goals. **Suggested strategy**: target the Euro and Sterling first as Tobin Tax currencies. As well, work with others to build expectation around the MDGs so that richer countries are pressurised not to renege from the pledges they made in the year 2000 to halve world poverty by 2015.

2) Developing countries
Poor countries are the prospective recipients of CTT income. Advocacy to seek their active endorsement of the CTT initiative is important. The Northern countries are more likely to respond if there is a groundswell of pressure from many directions. **Suggested strategy:** build sign up to an international CTT agreement. Lead countries in different developing regions of the world could help spur the process on.

3) Middle-income countries
These countries would benefit most from the second tier of the Tobin Tax, the circuit breaker component, to make their currencies safe from speculative attack. (This, of course, also goes for Japan, given current concerns about attacks from hedge funds). **Suggested strategy:** build sign up to an international CTT agreement through the creation of REGIONAL CURRENCY-STABLE AREAS. Explore the value that potentially exists if the new-found stability could lead to the conversion of currently unproductive foreign exchange reserves to pro-development purposes. Potential lead countries include: Brazil and India.

Tactics
In respect of helping to win the argument in the UK and Europe it is becoming increasingly clear that it is important to develop the 'Business Case' for the Tobin Tax. It is only a few powerful companies that benefit from extreme volatility in the currencies' market at present. The vast majority of businesses are ruined by the financial delinquency of a few giants. In the Landmines campaign, the argument was not won on 'humanitarian' grounds, it was crucially won because of the dubious 'military utility' of weapons that could not tell apart enemy forces from their own soldiers. We were able to use retired generals to significantly counter the arguments of serving military commanders. This tactic may be called playing the 'counter-intuitive card'. Making use of unlikely allies such as (well-known) business people who have lost out from currency collapses are a source of untapped potential – such people may well have the ear of finance ministers and their advisers.

Conclusion
The argument for income generation from the Tobin Tax is winnable if a very low-rate CTT is pursued; and the variable rate CTT to combat economic crises is also winnable, especially if voices from business see it is in their interest to act, and speak out.

The Tobin Tax campaign borne out of the traumas of the South-East Asian crisis has evolved towards one to meet the Millennium Development Goals. It is building and maturing into an idea that has the power to engage the most important features of how today's world operates and the most important forces seeking to effect change. It focuses attention on world poverty and offers a credible, possible way to do something about it. It focuses attention on the richest and most powerful financial actors and says their behaviour, especially in times of crisis, profits no-one but themselves, and that this way of behaving needs to be regulated for the general and greater benefit of us all.

The Tobin Tax tends to provoke controversy, and increasingly I encounter people who really want to challenge me on it. I think this is good because it signals how far the campaign has come.

Ghandi said about campaigning:
"First they laugh at you
Then they dismiss you
Then they fight you
Then you win."

Well, now they are beginning to fight us, I guess we're on the home straight.

Thank you for listening.