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On the Currency Transaction Tax

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The Currency Transaction Tax (CTT) means a lot of different things to many different people depending on the perspective one brings to it. In the 'Another World is Possible' Movement we can discern two specific strands: i) against the domination of capital and the severe damage the currency trade can cause; ii) the redistributive benefit that can be achieved through deriving taxation revenue from the vast amounts of currency traded ($2,000 billion each day). In an attempt to reach the best of both worlds the Movement jumped upon the idea of Professor Paul Bernd Spahn (about 5 years ago) who modernised James Tobin's original proposition to create a two-tier CTT, with a low and high rate. The low tier of the tax effectively skimmed the market to raise revenue, however it could be increased to a very high rate when a currency was under speculative attack in order to remove the incentive for such aggressive and destructive financial behaviour.

Stamp Out Poverty - a network of more than 50 UK charities, trade unions and faith groups – has concentrated over the last year on focussing specifically on the revenue-raising potential of the CTT to increase financing for development. To this end it de-coupled the two tiers and sequenced them, on the basis that progress on the low tier might lead to progress on the high tier, whereas (at least as far as experience in the UK was concerned) to attempt progress at the same time on both was leading to no progress at all. As well, we focussed specifically on applying the tax currency by currency (as opposed to universally), targeting our efforts on the achievement of a CTT initially on Sterling (by means of a Stamp Duty, a particular type of UK tax currently applied in the stock market).

In a bid once and for all to get a clear answer over the issue of feasibility of a tax on foreign exchange transactions, Stamp Out Poverty asked a leading financial advisory firm in the City of London, *Intelligence Capital*, to investigate whether a very low tax on Sterling transactions could be implemented, how such a levy could be plumbed into the international financial system and whether this could be achieved without a relocation of sterling currency trading. Their report 'A Sterling Solution' was published in November 2005.

Managing Director of *Intelligence Capital*, Professor Avinash Persaud - former head of currency research at JP Morgan, UBS Phillips and Drew and State Street Bank and former Visiting Scholar at the IMF - speaking in September 2004 about the implementation of a currency transaction tax on Sterling said: "I have changed my mind about the feasibility aspect. I think you present it as a stamp duty for foreign exchange, very simple and easy to do, which raises revenue."

Larry Elliot, Chief Economics Editor of leading UK newspaper *The Guardian* quoted Professor Persaud in February 2006: "Today, concern over settlement risk, money laundering and terrorist financing means that the activities of the banks that represent 90% of foreign exchange turnover is highly regulated. Under existing domestic and international banking regulation, these banks would face enormous regulatory, credit and technology costs if they tried to opt out of the evolving global settlement systems that make this tax easy to collect."

The findings of ‘A Sterling Solution’ have been extrapolated in an ‘Appendix’ to offer revenue estimates on all the world’s most traded currencies – see attached documents.

Critics of a CTT in the European Union say that the tax must be adopted on an international scale, as according to some opinions, it could lead to “relocations” or boycotting by financial operators in those areas in which it applied.

This runs counter to the findings of *Intelligence Capital’s* report, ‘A Sterling Solution’, which demonstrates how:

- **it is not necessary for a currency transaction tax to be universally implemented: it could be introduced unilaterally by any country or currency zone that wished to do so.**

In the European context, it is critical to make a distinction between the trade of the Euro throughout the world, and the trading of all currencies in the Eurozone. The *Sterling Solution* report clearly shows that the way forward is to concentrate on taxing the trade of specific currencies globally rather than the trade of all currencies within a geographical area. By proceeding in this way, a small tax on Euro transactions can be collected regardless of the geography of the trade because these transactions would ultimately be settled either through the Continuous Linked Settlement Bank (CLS) or the High Value Payment System, TARGET.

The report shows how a transaction tax on any individual currency:

- **could be implemented relatively cheaply using existing market infrastructure and networks,**

- **could capture the vast majority of transactions of the currency globally, and**

- **could be set at a low level and would therefore neither distort the market nor provide incentives for financial institutions to move outside current systems in order to avoid it.**

Debate on the Currency Transaction Tax (CTT) has recently been stalled because it has been widely assumed that, to be effective, a levy on currencies would have to be universally adopted and enforced. Whilst it may have been the case in the past that a CTT could not be implemented unilaterally, this is no longer so. Historically, the global foreign exchange (FX) market has consisted of disparate parts with little or no links between them - trades were conducted and settled manually by phone between counter-parties.

Today, the different components of the global FX market are built on the same technical platforms, use the same electronic messaging providers and trade electronically using the same systems. Furthermore, these trades are settled through either the recently established CLS Bank – which centralises the system and now settles around half of all global FX transactions – or through the High Value Domestic Settlement systems run by the world’s central banks.

The only way financial institutions could avoid a CTT on a specific currency would be effectively to remove themselves from the international FX transaction, messaging and settlement systems. However, the benefits they obtain from being in these systems dwarf the cost of a CTT levied at the low rate proposed.

The proposal is to levy the CTT at half of one basis point - 0.005%. This very small rate would avoid market distortions. If applied to Sterling and the Euro in traditional FX markets it could generate an annual $2.07 billion and $4.55 billion, respectively. Applying a CTT on Sterling and Euro to the FX derivatives market in turn would produce annual revenues of $1.15 billion and $2.65 billion. In total, therefore, we estimate that a CTT on Sterling and Euro could raise $10.41 billion. Assuming, conservatively, a 5% drop in volume traded (and some experts believe the 0.005% rate is so low that there will be virtually no reduction), this leaves a final estimate of $ 9.89 billion.

Political context and conclusion

Stamp Out Poverty representatives gave evidence to Jean-Pierre Landau for his report on Innovative Finance for France's President Chirac. The Landau report set out a menu of options for development financing which has had a significant impact. France with Brazil, Chile and Spain (now joined by Germany and Algeria), sometimes called the 'Lula Group' have been taking the lead on the implementation of innovative taxation to raise new revenue for development. This led in February 2006 to the first 'Development Tax' being agreed in Paris in the form of an Air Ticket levy, likely to raise in its first year between $200 – 500 million to be used for purchase of anti-retroviral drugs to combat HIV/AIDS. Whilst the Air Ticket Levy is only producing modest revenue it is an extremely important precedent and a potential stepping-stone on the way to the realisation of a CTT, which is becoming more and more realistic and feasible by the day.