

Sony Kapoorⁱ Speech at the Leading Group Conference held in Oslo February 2007

Financial Transaction Taxes and the Currency Transaction Development Levy

Introduction

A very good afternoon to all my dear friends and colleagues. It is an honour and a privilege to be in this great country which has moved dramatically from a violent Viking past to a peaceful present where it plays peacemaker and hands out the Nobel peace prize.

Norway has also led the way on key development issues, having instituted the concept of creditor co-responsibility, questioned the received wisdom on conditionality, committed to high levels of ODA and now having announced new commitments to the AMCs.

Let me contextualize my speech with saying how well Norway is perceived in international circles and how its standing is disproportionate to that of other countries with populations of 4 million. Let me also say that this has largely to do with the moral and intellectual leadership Norway continues to provide on key global issues, as highlighted by the minister, of global peace, international development and environmental protection.

Why stop when you are on a roll

Context

Extreme and Increasing Inequality

The world has never been as prosperous as it is now. It has also never been so unequal. Moreover, this inequality is on the rise, not just across countries but also within countries both rich and poorⁱⁱ.

For example, 300,000 of the richest Americans, less than 0.1% of the population, now earn more than 1,500,000,000,000 of the poorest people in the world, a full 25% of the earth's populationⁱⁱⁱ.

While more than \$30 billion was paid out in 2005 as bonuses^{iv} to a few thousand employees of investment banks in the 'City' of London alone – 11 million children, who could have been easily saved with a fraction of this money, perished from hunger and easily preventable diseases for want of less than a dollar a day.

Wealth is even more concentrated than income. This can be seen from the results reported by a recent UN study^v. The study shows that already in the year 2000, the richest 1% of the world's adults owned more than 40% of global assets. This degree of concentration of wealth at the top means, that the poorest half of the world's adult population own barely 1% of global wealth.

The MDGs will not be met

As minister Solheim put it succinctly this morning "*If we continue at the present speed we will not succeed.*"

According to the UN, sub Saharan Africa, the poorest region in the world which also has the lowest human development indicators, is not on track to meet any of the MDGs. In fact, of the 18 indicators measured by the UN 11 have shown no change or worse have deteriorated. South Asia is also off track on 14 of the 18 indicators.

The Logic

Financial markets have been perhaps the biggest beneficiaries of globalization. FX markets, for example, have expanded from about \$4 trillion in 1973 to \$40 trillion in the mid-1980s to \$450 trillion in 2004 – a more than 100-fold increase. Turnover in world equity (stock) markets has registered a seven-fold increase to \$51 trillion in a period of just 12 years since 1993 and the wealth held in the global bond market has increased more than three-fold to almost \$60 trillion now over the same period

Just skimming these vast financial markets, taking a tiny slice off the top, has the potential to generate billions of dollars that can be redistributed to save lives and achieve sustainable development.

They can provide predictable long term sources of finance which could grow over time. It has a very progressive incidence. It can be used to tackle some of the changes to tax structures in the current context.

Successful examples of Financial Transaction Taxes

There are of course a great many financial transaction taxes around the world. In the EU, the UK, France, Belgium, Ireland, Finland and Greece have financial transaction taxes. In the UK, the stamp duty on share transactions is levied at a rate of one half of one percent and it raises €5bn per year.

“Perhaps the best analogy of the proposed currency transactions tax is the securities transaction tax, called Section 31 Fees that have financed the US Securities and Exchange Commission since its inception in 1934.”

In 2003 the Peruvian government introduced a 0.1% general financial transaction tax, with the aim of raising finance for the education sector. It was widely reported that the tax would have serious negative consequences for the economy. In particular, they feared that bank deposits would be withdrawn, adversely affecting the availability of credit in the economy, and thereby restraining growth rates.

In fact, for many of the transaction taxes introduced in recent years such as in Colombia and Argentina, the financial sector has adapted itself to the transaction tax with no major repercussions, and this is despite the fact that the rates at which these taxes are levied are many multiples of the CTDL rates we propose in this report. The tax rates levied are in the range of 20 to 80 basis points and raise substantial amounts of revenue every year at very low collection costs and with few problems of evasion.

Moreover, the taxes have been collected mainly by electronic means through banks at minimal cost on behalf of the government. Income has ranged between 0.3% and 3.5% of GDP or 1.5% to 26.7% of total tax revenue with the cost of collection typically being 50 to 100 times cheaper than collecting income taxes.

Our proposal for the Currency Transaction Development Levy (CTDL)

Why the FX market –

It is important to remember that participation in the currency markets confers enormous advantage on financial institutions over and above the direct profits generated from FX trading. Besides the FX market is the largest market in the world and has benefited most from financial liberalization and globalization.

Current aid disbursements are often short-term and unpredictable, which is wholly unsuitable when dealing with long-term needs such as building infrastructures, assisting reconstruction or supporting people with illnesses, such as HIV/AIDS. A predictable and locked-in source of revenue such as a levy on currency transactions would provide a long-term source of income that could bypass the annual budget wrangling of ODA allocation. An additional advantage of taxing currency markets would be that because of their rapid growth they are likely to provide increasing amounts of revenue.

Our work draws on the latest research done by Intelligence Capital, some earlier work done by me and the pioneering work done by academic experts such as Rodney Schmidt. The first report was sponsored by the Co-operative bank and peer reviewed by experts. I myself am a former derivatives trader.

The CTDL is not the Tobin Tax

The CTDL, a small levy on currency transactions - fundamentally differs from the Tobin tax, therefore, in that it is born of a different time, proposed at a different rate and designed for a different purpose.

I repeat, The CTDL is not a Tobin Tax. Many of the well-worn and well-rehearsed arguments against the Tobin tax are not relevant here.

Tobin was offering a solution to countries trying to maintain independent monetary policy in a world of freer capital mobility. The object of Tobin's tax was to be big enough to change behaviour in the foreign exchange markets. He wanted to slow speculation. He was not concerned about a solidarity levy. The object of the currency transactions tax is quite different. Like most other turnover taxes, it is designed to not significantly alter behaviour; but to raise revenue.

Let me describe our proposal in some detail

The minister referring to the financial transaction taxes said “*a small tax of – 0.000 – I don't know how many zeroes will raise a lot of money*”. Let me state for the record that our proposal has four zeroes...

At 0.005% the proposed rate is too small to impact on the normal functioning of the market. Equally, it is not sizeable enough to warrant elaborate invention in order to avoid. At this rate, as we show below, a financial institution would lose more avoiding it, than it would gain. A CTDL at 0.005% is essentially uneconomic to avoid.

Also, due to the nature of the market, evasion is now technically difficult as foreign exchange transactions can be electronically traced. Moreover, payment systems are so important for financial stability that it is inconceivable that regulators will allow financial institutions to circumvent them for tax reasons or otherwise.

This means that once a country implements the levy, foreign exchange transactions involving its currency would be taxed, wherever they take place in the world, because the global settlement system provides ultimate recourse to the specific currency's Central Bank.

The CTDL is implemented by a country on its own currency, wherever it is traded in the world, as opposed to on all currencies traded in the country. A country's Central Bank features at the heart of trades of its own currency, wherever they are transacted in the world, including tax havens.

A combination of three things make the avoidance of a currency transaction levy extremely costly: the recent arrival of a single, global, real time settlement system for foreign exchange, the adoption of international banking accords on Bank capital adequacy and the development pervasive money laundering and anti-terrorist-financing rules.

How the CTDL would be collected^{vi}

‘...the infrastructure for settling foreign exchange trades is increasingly formal, centralized and regulated. This is due to new technology, subject to increasing returns to scale, and to cooperation between trading and central banks to reduce settlement risk. Settling a foreign exchange trade requires at least two payments, one of each of the currencies traded. Settlement risk is eliminated when payment obligations are matched and traced to the original trade, and then payments are made simultaneously.

The technology and institutions now in place to support this make it possible to identify and tax gross foreign exchange payments, whichever financial instrument is used to define the trade, wherever the parties to the trade are located, and wherever the ensuing payments are made.’

‘The payment system is an important part of a country's economic and financial infrastructure. Smoothly functioning payment systems make it possible to execute safe and timely payment transactions – for the settlement of goods and services purchases, capital transfers, securities and foreign exchange trading, and these transactions are made by private customers, banks enterprises and government agencies. These transactions result in claims between the payers' and payees' banks, and these claims are settled through the banks' accounts in Norges bank. Banks and the central bank are thus the core of the payment system.’

The messaging function pioneered by SWIFT (Society for Worldwide Interbank Financial Telecommunications) has become central to this process, as economies of scale considerations have made it increasingly sensible for all global players to use the same system. SWIFT, which is owned by the finance

industry, now supplies messaging services to more than 8,000 financial institutions in 206 countries and territories, and thus accounts for an important part of the financial infrastructure both nationally and internationally.

The feasibility of the CTDL

“Technically, it is possible to apply a unilateral sterling CTT via CLS... CLS Bank settle in fifteen currencies, and in doing so must apply the relevant laws in each jurisdiction – including, for example, a unilateral sterling currency transaction tax”. – UK Treasury

- It could be implemented relatively easily and cheaply, using existing market infrastructure and networks
- It would capture the vast majority of transactions carried out in a particular currency globally
- It would be set at a sufficiently modest level as to neither distort the market nor provide incentives for financial institutions to move outside current systems in order to avoid paying the CTDL.

Little impact on the market

While the volume or turnover would no doubt fall, it would not be by much. Liquidity in the market is different from the market turnover. Short term market volatility exceeds the commissions and spreads prevalent in the FX market today.

“When I was trading derivatives, in the time it take me to go to the bathroom and back, the range of very liquid exchange rates would be around five basis points, or one twentieth of one percent, and for less liquid currencies around one tenth of one percent. This range is a large multiple, ten to twenty times the size of the proposed levy. It is not going to affect my decision to hold on to a trade or pass it on because the time it takes me to think about it the currency has moved by as much.” – Avinash Persuad

The effect of the CTDL would be exactly the same as if the spread between the buying and selling price that currency traders offer were to rise from where they are today, around two basis points, to where they were three years ago at around two and a half basis points.

Market structure will not change dramatically as a result of the half basis point decline in the spread. Indeed, if you were to re-wind the trading room clock by three years and compared it with trading in other markets it would still be the largest most liquid of the financial markets.

No body was complaining that the market was not functioning well, or that in the space of these last three years that market functioning and risk management have improved.

Using the money

As important as raising the money is deciding how to spend it. In fact, the theme inherent in the work of the leading group of focusing money strategically towards the weak spots in the international efforts on development would leverage the positive outcome of such spending.

That is why, the MFA who commissioned the report requested us to present not just the state of the art CTDL proposal but also how the money could be effectively spent.

First, provision of clean water and sanitation, as it is a foundation stone that underlies the ability to make meaningful progress with the vast majority of the MDGs.

Second, providing human resources for health, because without sufficient trained health workers, medicines and infrastructure are simply not enough on their own to contain the raging pandemics of HIV/AIDS, TB and malaria.

Third, providing a long term predictable source of funds to an expanded UN Central Emergency Response Fund, to create a more robust response to the growing threat of natural disasters and humanitarian emergencies.

Action on any of these will have synergistic effects in moving towards meeting the MDGs and in our efforts on achieving sustainable development.

Taking the next step

So what is the way forward – we need to remember that the MDGs for example are not an end goal. The scale of the challenge facing us, is far greater.

Even after the MDGs are met for instance – 1 in 44 women will die in childbirth in Chad whereas the comparable figure in a country such as the UK is 1 in 5100.

As minister Solhiem said this morning, “we need to start this discussion somewhere – someone always needs to.”

It is relevant to point to some of the conclusions from the December experts workshop on the CTDL

There are no strong legal arguments against the unilateral imposition of a CTDL. The remaining “backbone” scepticism among mainstream economists could, in large part, be attributed to their not having read and studies the latest work on a CTT for Development.

The continuing throwing of arguments back and forth between the CTDL proponents and CTT/Tobin Tax naysayer’s may not necessarily be very fruitful.

The Urgency of the problem, each day delayed means more lives are lost. One of the key reasons why the CTDL is so important now is that it is more or less ready to be rolled out and could bring billions of dollars on- stream within a matter of months.

There were substantial difficulties in establishing an innovative mechanism such as the IFFm, but these were not insurmountable, given the political will to overcome them. The same logic should be applied to the CTDL.

As minister Solhiem said – “It’s simply a matter of political will.”

We call upon our hosts, Norway and the other leading group members to show this political will, this courage – as they have often done in the past and “Take the Next Step”.

Setting up a task force to take the issue forward in a tangible and rigorous way would be a logical first step.

Thank You

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Sony has played a leading role in international policy & advocacy on key development issues such as debt cancellation, innovative sources of finance, tax justice and capital flight. Sony handles the development economics program at Christian Aid, is the Director of Policy & Advocacy at Stamp out Poverty and an advisor to the International Tax Justice Network. He also sits on the boards of Eurodad, the International Tax Justice Network and Stamp out Poverty.

ⁱⁱ Capitalism’s Achilles Heel, Raymond Baker 2005

ⁱⁱⁱ Author’s estimate using data from the World Bank and New York Times

^{iv} “Wall Street Bonuses set new record in 2005” Press release dated 11th January 2006 from the Office of the New York State Comptroller available at <http://www.osc.state.ny.us/press/releases/jan06/011106a.htm> and “City workers set for £7.5 bn Bonus” reported on BBC online available at <http://www.news.bbc.co.uk/1/hi/business/4604346.stm>

^v UNU Wider (2006) Davies J, Sandstorm S and Wolff E, ‘The World Distribution of Household Wealth’

^{vi} From Taking the Next Step