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The North-South Institute

Briefings *from* The North-South Institute

The Currency Transaction Tax
A bold idea for financing development

An idea whose time has come

Global problems require bold solutions and the Currency Transaction Tax (CTT) is one such innovative idea. It proposes a small levy on foreign exchange transactions, using the money raised to finance development projects for the global public good. Rodney Schmidt, The North-South Institute's Principal Researcher for Finance and Debt, has completed key research[1] proving that the CTT is feasible and could raise billions of dollars for development without affecting foreign exchange markets. Schmidt and John Foster, Principal Researcher for Civil Society and Governance, have taken the research forward in the United Nations (UN) and other inter-governmental forums, eliciting significant interest.

Why do we need a CTT?

The world's countries adopted a declaration in September 2000 establishing Millennium Development Goals (MDGs). These included specific targets for poverty reduction, health, education, gender equality, environmental sustainability, and global partnerships — all to be reached by the year 2015.

The international community struck an agreement under the Monterrey Consensus in 2002 for means to achieve these goals. Developing countries assumed primary responsibility for implementation while industrialized countries, including Canada, committed to supporting those efforts through aid, trade, and debt relief.[2]

Sadly, the international community has not provided the funds needed and it is increasingly unlikely that the MDGs will be met. The World Bank reports that developed countries have not met their commitment to devote 0.7% of Gross National Income to Official Development Assistance (ODA).[3] The Group of Eight industrialized nations have not met their pledge to double aid to Africa by 2010. Multilateral financial institutions are increasingly being marginalized as a source of development finance. Bilateral aid often falls short of what is required and its availability and allocation is often highly politicized. Private flows of finance are not a reliable source of finance for many developing countries.[4]

This is a pivotal time when serious new challenges are being posed by climate change, the price and availability of food, and escalating energy costs. There is fear that even minimal development goals could be reversed as increasing numbers of people are pulled back into poverty, hunger and disease. In the face of this development emergency, there is an urgent need for new ideas and initiatives. Poverty, epidemics and climate change are problems without passports that demand solutions without borders.

How would a CTT work?

The CTT would, in the words of former French president Jacques Chirac, be a tax on the benefits of globalization.[5] It would take the form of a small percentage levy on individual foreign exchange transactions, assessed on dealers in the market and collected by financial clearing or settlement systems. The tax would be easy to implement and difficult to evade, since all foreign exchange transactions are completed in a few large, centralized settlement structures. They already collect transaction fees levied to pay for conversions from one currency to another.[6]

NSI Principal Researcher Rodney Schmidt, undertook innovative research in 2006 and 2007 to examine the CTT in detail. In his recently published findings, Schmidt estimates, conservatively, that a CTT of a half basis point (0.005%) on each transaction in major currencies would yield annual revenue of approximately US$ 33 billion, without disrupting foreign currency markets.[7] "We identified an appropriate CTT rate," Schmidt says. "It's high enough to raise lots of money but low enough to avoid changing fundamental market behaviour."

The levy would be minimal but, at an estimated $1 trillion per day, the volume of international currency transactions is immense. Money generated by the CTT would be allocated for development and administered multilaterally. Decisions have not been made about the details of that administration but the revenue would be seen as additional to ODA commitments and would not be considered part of the envelope of bilateral aid. The money could, for example, be placed within an agency such as United Nations Development Programme (UNDP), which coordinates global and national efforts to reach the Millennium Development Goals.[8]

The CTT and its Critics

Proposals for a CTT have moved from utopian to mainstream within just a few years but the idea does have its critics. American economist James Tobin first proposed a currency tax in the 1970s as a means of slowing the flow of capital across borders and preventing exchange rate crises. The call for a Tobin Tax gained adherents following the financial crises that rocked Mexico and a number of Asian countries in the 1990s. In March 1999, the Canadian Parliament passed a non-binding motion calling for a Tobin Tax and a number of Canadian municipalities called for it as well. The current financial crisis will likely spur renewed interest in a tax to regulate currency rates.

Critics said that the Tobin Tax would reduce the volume of foreign currency trading and create inefficiencies in the trading market. The Tobin Tax would have been set deliberately at a higher level to affect foreign exchange market behavior. The CTT, in contrast, is intended to raise money without disrupting the market and the proposed rate is low. Most of those who campaign on behalf of a CTT today see it primarily as means of providing funds dedicated to social development and poverty eradication programs.[9]

The technical work of Rodney Schmidt and others has convinced even many sceptics that implementing a CTT is feasible. "We've done our homework," says Schmidt. "Our research shows that the tax is possible and practical, and that it can be both monitored and implemented." To illustrate, he compares it to the tax on air tickets that has been implemented to finance the campaign against pandemics.

Who supports a CTT?

Some of the most influential countries in global finance already support the CTT. In addition, The CTT is being discussed at the United Nations[10] and in various national and international forums, and is supported by many civil society organizations. In 2003, then French President Jacques Chirac appointed a panel of independent experts led by Jean-Pierre Landau to investigate innovative financing mechanisms to

> *There is renewed international interest in a possible currency transaction 'development levy' of 0.005 per cent, a minuscule tax that is not expected to materially affect market operations while having the potential to generate billions of dollars that can be allocated for development …by their nature, Currency Transaction Taxes involve more than one country, being levied on exchanging the currency of one country for another …these are taxes that are best implemented in a cooperative manner among countries.*
>
> — United Nations Secretary General Ban Ki-Moon, (2008)[11]

> *This type of tax has a broad global base, so there is the potential to use it for global needs and to support global issues, such as climate change, or international catastrophes, or key international development projects.*
>
> — Rodney Schmidt, Principal Researcher, The North-South Institute[12]

support development. The Landau Commission concluded that paying for development principally through the national budget allocations of OECD donor countries would not achieve the Millennium Development Goals. The commission proposed a variety of other options for additional and improved assistance, and called for the establishment of levies coordinated internationally but implemented at the national level.[13]

In 2004, more than 100 countries meeting at a UN Special Session endorsed a proposal by Brazil, Chile, France, Spain and other countries urging action on innovative CTT-type financing.

Also in 2004, Belgium became the first country to legislate a currency transaction tax within its borders. The law will come into effect only when similar action is taken by other European Union governments, or by EU regulation.[14]

Following an international conference in 2006, France and several other governments launched an airplane ticket tax, with proceeds to support an international drug purchase facility to assist the campaign against pandemics.[15] Speaking at that meeting, former president Chirac described the CTT as "economically rational and technically feasible."[16] The levy has been applied in eight countries with no measurable impact upon air traffic and has raised hundreds of millions of dollars for international development.[17]

In 2007, an all-party Parliamentary group in the United Kingdom recommended either a stamp duty or a levy on transactions in sterling currency to fight world poverty. The group heard expert testimony from Nobel Prize winner Joseph Stiglitz and also considered the research conducted by Rodney Schmidt for NSI.[18]

In 2008, an all-party committee of the Japanese Parliament acknowledged "the growing international acceptance towards a CTT and its effectiveness."[19]

In 2008, the UN Secretary-General Ban Ki-Moon wrote a note regarding the CTT for use in a key meeting with the International Monetary Fund, the World Bank, the World Trade Organization and the United Nations Conference on Trade and Development. The Secretary-General's notes echoed closely NSI's research regarding a CTT levy on foreign currency transactions.

The Road Ahead for CTT

The CTT has gained momentum, particularly since the 2001 Monterrey Conference on Financing for Development. "We have reached a key moment," says John Foster, NSI's Principal Researcher for Civil Society and Governance. "There are international meetings in the offing that will allow us to update and change the commitments made in Monterrey back in 2002."

Much of the impetus for the discussion of innovative financing mechanisms is coming from an intergovernmental organization called The Leading Group on Solidarity Levies to Fund Development. The group consists of about 50 nations that support innovative financing for development and includes France, Brazil, Norway, South Korea and Senegal. The Leading Group provides a space for new innovations to be discussed, supported and undertaken. The 2006 decision to introduce a solidarity levy on airline tickets arose in this forum. The Leading Group has also welcomed the participation of academics, the private sector and others. A group of 30 civil society representatives met in Dakar, Senegal in April 2008 to build support for innovative financing in preparation for the Leading Group's Financing for Development conference in Doha, Qatar in November-December.[20] The Leading Group, meeting in Dakar, welcomed the results of the civil society event and heard from the Institute's John Foster, among others. A new coalition — "The CTT for FfD" — has been formed among NGOs, and an informal group of sympathetic governments has been organized to move the issue forward.

> *Following years of adhering to the widespread illusion that globalizing the economy would be enough to solve all development problems, the international community is finally accepting the need for solidarity. The solution is new financing mechanisms that mobilize part of the benefits of globalization …With these contributions, we are going to extend our solidarity base using a fraction of the new wealth created by the globalization process, a large part of which escapes states' taxation. We are going to use the most advanced techniques of our modern economy in the interest of the poorest.*
>
> — Former French President Jacques Chirac (2006)[21]

Many governments that have expressed an interest in innovative financing for development have not gone beyond making sympathetic noises. There are at times keen disagreements between Parliamentarians who are supportive and their finance ministries and central bankers who are not. Despite a non-binding motion in favour of a currency tax passed by Canadian Parliamentarians in 1999, the federal government has taken no action in the intervening decade.

The time has come for a pilot country or group of countries to demonstrate the feasibility of the Currency Transaction Tax, its minimal impact on financial markets and its benefit to the global public good. The role of civil society will be key in encouraging sympathetic governments to act. If proposals are to progress, the arguments in favour will have to be made forcefully to national governments, their citizenry, and to the international community.

The North-South Institute sees its role as one of conducting policy-relevant research on key issues related to international development, sharing that research with those who will use it to effect change, and keeping urgent development issues before policy-makers and the public.

"Our research work," says Rodney Schmidt, "shows that it is possible to implement, monitor and collect such a tax."[22]

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ENDNOTES

1 The North-South Institute and Principal Researcher Rodney Schmidt acknowledge and thank the anonymous donor who financially supported this research. As well we thank War on Want, UK and the United Nations University, Tokyo, for administering the project.
2 Canada and the Millennium Development Goals, CIDA, http://www.acdi-cida.gc.ca/CIDAWEB/acdicida.nsf/En/JUD-13175444-H69
3 The Global Monitoring Report 2008 findings were presented in PowerPoint form at the UN ECOSOC High Level Meeting in New York in April 2008. For details see: http://siteresources.worldbank.org/INTGLOMONREP2008/Resources/4737994-1207342962709/8944_Web_PDF.pdf
4 Breaking the Taboo: Perspectives of African Civil Society on Innovative Sources of Financing Development, 2008, pp: 9-10. Available for downloading at: http://www.commonwealthfoundation.com/
5 Ibid., pp: 7-8.
6 Thirty Years of Leadership in Development, The North-South Institute Annual Report, 2006-07, p. 4.
7 The Currency Transaction Tax: Rate and Revenue Estimates, Rodney Schmidt. The North-South Institute, October 2007. See Abstract, also pp. 4-9. available for downloading at: http://www.nsi-ins.ca/english/research/completed/03.asp
8 See Breaking the Taboo, p. 26.
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11 Paragraph 1.6 of the note of the Secretary-General of the United Nations, Coherence, coordination and cooperation in the context of the implementation of the Monterrey Consensus, including new challenges and emerging issues, E/2008/7, 14 March 2008.
12 This information is drawn from interviews with Rodney Schmidt and John Foster used in the preparation of a Podcast on the CTT. To download the Podcast see: http://www.nsi-ins.ca/english/podcasts/default.asp
13 The Landau Commission Report on Innovative Development Funding Solutions, 2004.
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17 Breaking the Taboo, p. 8.
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22 United Nations University Press, The Currency Transaction Tax: Rate and Revenue Estimates, by Rodney Schmidt; November, 2008; ISBN: 978-92-808-1159-9; 42 pages.