

TWN

Third World Network

*TWN presentation for UNCTAD Symposium on the financial crisis and global economic governance:
Break-out session on SDRs, FTTs, and reform of the global reserve system
Geneva, May 10, 2010*

After introducing the basic aspects of the financial transaction tax, this presentation will focus on three aspects. First, the perspectives on the case for a financial transactions tax from a developing country point-of-view. Second, the views of G77 member countries in the General Assembly of the United Nations in New York. Third, the significance of other reports that will mention the FTT, besides the IMF draft report to the G20 of April 2010. The High-Level Taskforce on International Financial Transactions for Development (which has both developed and developing country members) as well as the follow-up to the June 2009 UN Conference will provide important analyses on the policy proposals and feasible options on tax schemes in the financial market.

The Crisis Context: Costly responses shouldered by the state and public

In the last few years the global community has faced the deepest financial crisis and economic recession since the Great Depression over 80 years ago. The governments of developed and emerging market countries responded by injecting huge amounts of liquidity into the financial system and bailing out the most troubled financial banks and firms. Stimulus packages were introduced in developing countries which cover a wide range of areas including infrastructure investments in both China and India to specific trade protection for certain industries, such as in the 'Buy America' in the US, and various types of resource transfers to households and the unemployed.

These expenses were made by governments often at the cost of significant, unprecedented public debt and budget deficits. The staggering fiscal cost of the crisis results not only from government expenditure but also from the loss in economic output due to the contraction in global demand and international trade flows, the credit crunch caused by the unwillingness of indebted banks to lend and provide credit, and the lost tax revenue due to the spike in unemployment numbers caused by the recession. Also important are the social costs of the crisis, such as unemployment, cuts in wages, bonuses and insurance, reductions or freezes applied to national pension funds, and decreased investments in social services and public sector budgets such as education and health.

The origins of the financial crisis have been globally acknowledged in the increasing deregulation and lack of supervision in the deeply interconnected financial markets across the globe, which resulted in harmful speculative investments and the 'subprime mortgage crisis.' However, even as governments provide record levels of financing to rescue failing banks and insurance companies, these very institutions are making record profits. This has confused and angered the global public, resulting in a serious loss of trust in the financial system. Many in the global community, both leaders and the public at large, want to ensure that the financial actors who caused the crisis also take some responsibility to pay for the costs of the crisis, which have critically affected both government and household budgets.

The Global Call for a Financial Transactions Tax

It is this context within which a global movement urging for financial transactions taxes (FTTs) is called for. The FTT would be a relatively small tax of about 0.05% that would be levied on all financial market transactions. This would cover any financial transaction traded through stock exchanges, futures exchanges, and transactions traded on off-exchanges (or "over-the-counter"). Specifically, the FTT would be levied on trading in stocks, bonds, foreign exchange and derivatives, such as futures and options related to stocks, currencies and commodities.

The FTT would be limited to transactions between financial market actors. Ordinary consumer transactions such as payments for goods, paychecks and cross-border remittances would not be subject to the FTT; and short-term inter-bank lending and central bank operations would also be excluded from the FTT.

The key argument for the FTT is that it is an important, appropriate and just instrument to ensure that part of the enormous cost of the crisis is recovered from the very place that caused it: the financial institutions that engaged in speculative transactions. The significant amount of revenue generated from the tax would provide governments the ability to finance the national fiscal gap caused by expensive crisis responses as well as the urgent need for development financing and liquidity in developing countries.

The **technical argument** for the FTT is that it will address excessive speculation by making short-term speculative transactions more expensive. Many experts argue that a transaction tax will curb the amount of speculative trading taking place and will have a stabilizing effect on asset prices. Over the long-term, proponents of the FTT say it will reduce the overall size of the financial sector relative to the real economy. In 2008, the trading of financial transactions had soared to about 74 times higher than nominal global gross domestic product; whereas in 1990, it was only 15 times higher. Similarly, the trading of derivatives and foreign exchanges has far surpassed global trade. The ‘casino economy,’ in which money is the traded commodity, rather than goods and services, has segregated the real economy of jobs, production and income growth, from the financial economy, where speculation has led to the chronic occurrence of ‘credit bubbles.’

National political parties, and state leaders, have come forward in support of the FTT, calling for the tax to be introduced internationally, or across all major international financial markets. The majority of political support is coming from European leaders such as French President Nicholas Sarkozy, German Chancellor Angela Merkel and UK Prime Minister Gordon Brown. The European Union parliament in Brussels has stated in its resolution on the effects of the global financial and economic crisis on developing countries, on March 25, 2010, that the EU parliament:

“Firmly believes that taxing the banking system would be a fair contribution from the financial sector to global social justice; calls also for an international levy on financial transactions to make the overall tax system more equitable and to generate additional resources for financing development and global public goods, including adaptation of developing countries to cope with and mitigate climate change and its impact;”

President Barack Obama has stressed, *“We should institute a Financial Stability Fee on the entire financial services industry to repay any losses to the American people and make sure we are never asked to foot the bill for Wall Street’s mistakes again.”*

The Chairman of the British Financial Services Authority, Lord Turner, has said that he is “happy to consider taxes on financial transactions” if increased capital requirements are insufficient to help shrink a swollen financial sector. And well-known academics such as Joseph Stiglitz, Paul Krugman, Dani Rodrik, Jeff Sachs and Paul Volcker have also recently voiced explicit support for the FTT, as have influential financiers such as George Soros and Warren Buffet.

An official statement by the German Bundestag, the lower house of the German parliament, said that:

““There is a massive loss of trust in the financial market. It will also result in a loss of trust in the government if politicians fail to make those who caused the crisis share the liability and to demand and enforce a greater responsibility on the part of the financial sector for the common good and society as a whole. Never before was there such a window of opportunity as today to finally arrive at an international agreement and to introduce a general tax on financial transactions.”

Estimates for how much revenue the FTT tax will be able to generate range from between \$200 to \$900 billion annually, depending on the particular formula, the rates and any exemptions, such as

basic personal exemptions or transactions by pension funds, that some have proposed. **The Austrian Institute of Economic Research has estimated that a global transactions tax of 0.05% could yield between \$47 billion and \$1022 billion a year**, even assuming a drastic reduction in market activity by 65%, at the extreme.

Financing Needs in Developing Countries

An acute need for resources for development finance needs across most developing countries persists. The current context in the developing world is one in which the mobilisation of financial resources is in a crisis mode: ODA flows have plunged severely; private capital flows have turned into outflows; the trade shock has sharply decreased export revenues, and so on.

The European Union Parliament, in its resolution on the impact of the financial crisis on developing countries, “Notes with great concern that developing countries are expected to face a financial shortfall of USD 315 billion in 2010.” The World Bank, in its Global Development Finance report in 2009, estimated that “With private capital flows expected to post a dramatic decline, many [developing] countries will have difficulty meeting their external financing needs, estimated at \$1 trillion.”

The drop in economic activity, combined with much weaker capital flows to developing countries, has placed a large number of low- and middle-income countries under serious financial strain. Many countries are having difficulty generating sufficient foreign currency from exports or borrowing to cover import demand. Although many developing countries are meeting this financing gap by drawing down on the international currency reserves they built up before the crisis, this strategy is clearly not sustainable. According to the World Bank, since September 2008, 16 low-income countries have consumed 20% or more of their foreign reserves, and the current stock of reserves covers less than 4 months of imports in 18 countries.

The revenue collected through the FTT, or bank levies as proposed by the IMF, should be pooled in a global fund and used partly to compensate the damage done to developing countries by the financial instability caused by speculation of international banks and firms, predominantly based in rich countries. With regard to how deeply interconnected developing country financial markets are to those in developed countries, the South has a fundamental interest in preventing speculative bubbles and financial instability in the rich world, as it cripples the financial sectors of developing countries too.

Specific portions of the revenues of the FTT should also be allocated to developing countries. Developing countries are innocent victims of the current financial crisis which has its origins in the rich world. Without having a role in causing the crisis, developing countries still face severe balance of payment problems, falling revenues and reserves, and liquidity gaps. Developing country financial markets have been aggravated by the wrong investments promoted by western banks.

Developing countries have a right to access part of the funds raised by taxes on banks. **These funds should be made available to developing countries for purposes such as:** filling liquidity gaps, preventing new debt crises, finance debt restructuring exercises, as well as development spending (e.g. expansionary fiscal spending) in order to offset increases in poverty and unemployment that have occurred as a fallout from this current crisis, and to meet the Millennium Development Goals.

The IMF’s Report: Bank levies favoured over the FTT

The IMF’s report advocates for bank levies (Financial Stability Contribution (FSC) and Financial Activities Tax (FAT), which address only the profits and bonuses of banks through imposing a tax on the holdings of banks. Despite the lack of explicit support from the IMF, it is not all bad news. The IMF admits that the FTT would be possible to implement and that it is feasible on purely technical levels. **The FTT should still be advocated for as there is still a strong case for such a tax to provide revenues of scale for both domestic and international development finance purposes, as well as to curb the destabilizing nature of speculative trading by increasing the transaction cost.**

With regard to the IMF's proposals, neither the FSC or FAT would generate consistent revenues of the scale and magnitude of the FTT; nor would they increase the cost of speculative activity. **They can be seen as levies that impose slaps-on-the-wrists of the biggest profit earners in the financial sectors, rather than impacting the kind of activity they undertake to earn these big profits.**

It is important to note the fundamental difference between the IMF's proposed bank levies versus the FTT. The proposed bank levies impact the **holdings** of banks, which may include revenue generated from risky speculative activities. However, the FTT would **increase the cost of risky activities**, such as speculative financial transactions, and thus impact the activity itself (whereas a bank levy makes no impact on the type and scale of activity pursued by the bank). Equally important is the fact that the FTT would generate progressive revenues on an ongoing basis, and would thus be a forward-looking tax. However, the bank levy would only be a backward tax, in that it affects profits that have already been made, not profits that will be made on a future, ongoing basis.

The FTT constitutes a pro-active tax regime that would not only generate revenues of scale, but also contribute toward redistributing the exorbitant wealth of the financial economy as compared to the real economy.

However, the FTT and the bank levies proposed by the IMF are not the same thing. Both can be implemented as they would each serve different purposes and can each generate important levels of revenue while serving to address financial market excesses.

G77 Developing Countries Support the FTT for Development Financing

On the question of generating resources for development financing many G77 member countries, such as Brazil, Venezuela, Pakistan and Indonesia, expressed that in theory nobody from the developing world would disagree on the allure of the FTT being able to generate revenues of scale, such as the most commonly heard figure of \$100 billion per year. Such an infusion of funds, on a regular and additional basis, would be welcomed if a portion of it, such as the 50% proposed by the Robin Hood Tax Campaign, could be allocated to developing countries for their sovereign development finance purposes. Solidarity levies and other taxes of a similar nature have been brought up in the past and have been supported by most G77 countries.

However, many developing countries have expressed some caution and are asking questions such as how FTTs would impact developing country investors, firms and banks? Furthermore, how would the **impacts vary** between emerging market economies like China and India and low-income countries, including Caribbean island countries that are tax-havens? Are there any types of transactions to **avoid** in FTTs that are particularly **sensitive for developing countries, such as remittances**? There are also concerns on how potential revenue from FTTs will be **channeled and disseminated from financial market centers to developing countries**, and what needs will be prioritized, according to the differing needs of countries.

Pakistan stresses the importance of channeling funds through a multilateral body that is governed democratically, where developing countries have an active voice in defining their distinct needs and priorities. Other G77 member countries also highlighted the potential dangers of bilateral transfers of funds from rich countries to developing countries, as rich country national political interests can often be attached.

Brazil is concerned that when civil society advocates call for a portion of FTT revenues to be directed to 'global public goods' in developing countries, the term can often be "too vague." For instance, "what exactly would be considered a 'global public good' and who decides its parameters"? Sovereign decisions should be respected on what constitutes a global public good—but that could also result in very different definitions for different countries.

Importantly, Brazil states that FTTs are technically viable. Coming from their own recent experience of state-managed intervention in the national financial market, Brazil does not foresee serious competitive disadvantages for financial markets on a level that would cause major disruptions

or damage for the international financial markets. Furthermore, they say that it is not true that harmonization is needed for FTTs to come into operation, and that this would need to be better supported through studies to respond to the argument that all countries have to implement the FTT together in order to prevent competitive asymmetries that could disrupt financial markets. However, Brazil also says that FTTs are complex, politically sensitive, and will take some time to put in to place.

Chile stated that the High-Level Taskforce on International Financial Transactions for Development is a significant development that they are placing serious attention on in their government. The Taskforce is currently developing proposals for political action on FTTs, which will carry weight if the governments involved in the Taskforce decide to support these political actions nationally. The Taskforce aims to frame FTTs as a way to “not only slow down speculation, but to get actual resources of *scale*.”

Countries such as Germany, France, the UK and Norway – all of which have nationally supported the FTT – are extremely important for building the political feasibility and practical agenda for the FTT in the years ahead, Chile said, and therefore, it is critical that these developed countries work in partnership with developing countries which support the FTT, such as Chile and Brazil, for instance.

Other Reports and Studies on FTT

The IMF’s report on the FTT is not the international only report that will provide an assessment of the feasibility of the FTT. The intergovernmental body of the **High-Level Taskforce on International Financial Transactions for Development** and the **United Nations General Assembly** will both produce reports that offer different perspectives on the feasibility of the FTT, and these perspectives will differ given that the context within which the above bodies will assess the FTT is one of the development financing needs of developing countries. The High-Level Taskforce is integrating into its report the financing requirements of developing countries in order to facilitate achievement of the MDGs; and, the United Nations is examining the external financing gaps and increased debt burdens of developing countries, which will frame the urgency and amount of financing that will be called for in its report.

The **Outcome Document** of the June 2009 UN conference on the financial and economic crisis has a paragraph on new and innovative forms of financing.

The relevant paragraph is:

Paragraph 31: “New voluntary and innovative forms of financing can contribute to addressing our global problems. We encourage the scaling up of development finance from existing sources and the establishment, where appropriate, **of new voluntary and innovative sources of financing initiatives to provide additional stable sources of development finance, which should supplement and not be a substitute for traditional sources of finance and should be disbursed in accordance with the priorities of developing countries and not unduly burden them.** We reiterate our request to the Secretary-General to produce a progress report by the sixty-fourth session of the General Assembly, taking into account all existing initiatives.”

There is a follow-up process to the UN Conference, in which an Ad-Hoc Working Group will be preparing a final report for the General Assembly in September 2010.

Another key report is the **High-Level Taskforce on International Financial Transactions for Development**. It was created in May 2009 in Paris, by the Leading Group on Innovative Financing for Development, which was created in 2006 to discuss and formulate proposals on taxes for financing development. **The Taskforce is mandated to assess the technical and legal feasibility of a financial transaction levy and voluntary contributions based on international financial transactions.** A question which will be taken into consideration in the Taskforce’s assessment is that of how tax proposals can redistribute a small fraction of wealth generated by globalized activities. Such a focus on redistribution of the asymmetric wealth generation in the global economy immediately differentiates this Taskforce from that of the IMF.

This Taskforce will produce a report in May 2010 which will be authored by its Committee of Experts, which includes many global experts on tax and financial policy. The Taskforce will strive to reach consensus on this report, which will examine the costs and benefits of different tax policy options, taking into consideration the volume of international financial transactions and its actors, as well as the context of financing needs for the MDGs in developing countries. **By addressing development needs, this report will be markedly distinct from the IMF report and will provide a more development-oriented lens by which tax policies in the financial market will be assessed.**

The Taskforce has significant political support and leadership from developed countries such as France and Norway, and developing countries such as Chile and Brazil. The first countries to have attended the Paris meeting in September 2009 are: Austria, Belgium, Brazil, Chile, France, Germany, Japan, Norway, Senegal, Spain and the United Kingdom. It will be up to these political leaders to assess, drawing on the report produced by their Committee of Experts, whether or not the mechanisms proposed should be introduced.

The United Nations has addressed the issue of financial transactions levies in the past on various occasions. A key example is a report submitted by Brazil, Chile, Spain and France to the Secretary-General in 2004. The report concluded that:

“Despite the (...) obstacles, the proposal to levy a tax on financial transactions at a very low rate would lead to the collection, on a stable and predictable basis, of a significant amount of resources for development while not interfering with the normal functioning of the market.”

For more information contact:

Bhumika Muchhala
Finance and Development Programme
Third World Network (TWN)
Email: bhumika@thirdworldnetwork.net | Web: www.twinside.org.sg