An international transactions tax?

Alongside progressive tax reform in the national economy, there is a strong case for more coordinated action on a global scale. Taxation authorities in different nations are already trying to crack down on 'transfer pricing' and other forms of tax avoidance by multinational corporations. The introduction of a tax on international transactions in foreign exchange markets is another possibility worthy of careful consideration.

This tax was first proposed by, and has since been named after, the American economist James Tobin, a former winner of the Nobel Prize in Economic Science for his work on economic theory and policy. Tobin presented the idea for a currency transactions tax on his 1977 Presidential address to the Eastern Economic Association in the USA, subsequently published as *A Proposal for International Monetary Reform*. In the subsequent decades it has received intermittent attention, but there has recently been a particular flurry of interest recently in the proposal, triggered by the instability of international financial markets. The global financial crisis has been a potent reminder of the destabilizing effects of speculation and the difficulty any one country has in insulating itself from global economic crises.

That financial markets are the source of particular types of economic instability is widely recognized. The growth of foreign exchange transactions has been particularly prodigious, far outstripping the growth of foreign trade. Based on a comparison of the total value of international currency transactions with the total value of trade in goods and services, one may infer that at least forty-nine out of fifty currency transactions on the Australian Forex market are concerned with some form of hedging or speculation. An estimated four fifths of foreign exchange transactions involve 'round trips' of seven days or less (i.e., the currency is sold again within a week): most 'round trips' occur within one day.

Tobin suggested a tax in the range of 10-25 cents per $100 value of the currencies transacted, probably at the bottom of that range in the first instance. A tax at this rate could be expected to have a major impact on incomes derived from short-term speculation; but it would be a trivial charge on commodity trade or long-term foreign

investments. If banks and currency dealers are taxed only on changes in their end-of-day open positions, an estimated one third of the gross volume of transactions would be taxable. Allowance must also be made for a tax-induced reduction in the volume of short-term transactions, since this is part of the purpose of the tax. A tax of this sort, like any indirect tax, generates more revenue the less of the taxable activity that it discourages. From the viewpoint of the taxing authorities, there is benefit either way – discouraging the activity or generating revenue. In this respect there is a parallel with a tax on smoking or a carbon tax.

Securing some form of international agreement would be a necessary part of moving forward on this proposal. Otherwise there is the danger that the tax would push transactions to tax havens. To counter this danger it has been suggested that the tax could be administered by a central body such as the International Monetary Fund, each member country being required to comply with levying the tax as a condition for membership and borrowing privileges. Of course, governments of countries that are currently tax havens might reasonably judge that exclusion from the IMF would be a small price to pay for continuing the financial advantage that they enjoy. Exclusion from the United Nations, making them in effect pariah states, would be a more severe penalty. It is pertinent to note that James Tobin himself thought that this problem of tax havens would be minor. In his own words, 'the already existing attractions of low-cost sites for financial dealings do not seem great enough to drive them away from London. New York and Tokyo. I doubt that the transactions tax would move them either. Perhaps agreement on the tax among the G-7 countries and a few other financial centres – the sites of big bank foreign exchange dealers – would suffice'.

The disposition of the international transactions tax revenues between international and national purposes is also a matter needing further consideration. One possibility is that individual nations might retain 50 per cent, with the other 50 per cent going to an international fund to foster the development of poorer nations and for other international purposes. The objectives of the tax are essentially two-fold: to reduce short-term speculation and to allow for greater autonomy and effectiveness of national macro-economic and monetary policies. Using at least some of the revenues for developmental purposes would add a global equity dimension to these objectives.

This is a reform issue on which Australia could take a lead in international forums – joining the growing chorus of political leaders advocating the introduction of an international transactions tax. It may readily be conceded that, even with international support, there would be substantial obstacles to its implementation. However, in the context of continuing crises in the world economy, it may be said that this is an idea whose time has come. Allowing the continuation of untaxed speculative processes is contrary even to the long-run interests of global capitalism. International financial transactions that emphasizes wealth capture though short-term capital gain undermine the conditions for wealth creation and have significantly destablising effects. Developing a tax regime, both at the national and international levels, that steers resources from speculative activities towards productive purposes has a strong political economic rationale and should have widespread appeal.