

taking the **NEXT STEP**

Implementing a Currency Transaction Development Levy

by David Hillman, Sony Kapoor
and Stephen Spratt

The Government will: Act as a spearhead for international agreements on new global financing sources that can contribute to a redistribution of global wealth and the strengthening of the UN institutions, such as aircraft tax, carbon dioxide tax, tax on arms trade or duty on currency transactions.

From the Norwegian Government's Declaration on International Policy
(The Soria Moria Declaration)

Commissioned by
The Norwegian Ministry
of Foreign Affairs

**STAMP
OUT**
Poverty



Solidarity Levies to fund development

Extracts from the message from the Norwegian Presidency of the Leading Group:
'In view of the challenge of the Millennium Development Goals and the current gap between these goals and the financing available to reach them, Norway finds it imperative to help stimulate additional efforts, including through new and innovative mechanisms... Such levies can be easy to implement, their collection costs can be made minimal, national tax sovereignty need not be affected, and they...can be implemented without waiting for universal participation.'

'... [in respect of the first solidarity development levy] proceeds will be used to combat HIV/AIDS, malaria and tuberculosis, through the new international drug purchase facility UNITAID. This facility, officially launched in New York on 19 September 2006 will be hosted by the World Health Organisation... It is an important pilot project, which we believe will demonstrate the virtues of pooling resources mobilised by way of innovative financing schemes.'

While this message refers to the Airline Ticket Levy, this report comprehensively shows how the exact same analysis – easy implementation, minimal collection costs, no affect on national tax sovereignty and unilateral feasibility applies to a Currency Transaction Development Levy and calls on the Leading Group to respond to some of the most urgent development challenges by implementing the CTDL and leveraging the proceeds in a strategic way to target the 'weak spots' in the international development effort.

From the Norwegian Government's Declaration on International Policy (The Soria Moria Declaration):

'World poverty is an infringement of human worth, a violation of human rights and a threat to global security and the environment. The fight against poverty and for the right to economic development, democracy, human rights and sustainable development constitutes the greatest challenge for the world community and a principal task for the Government.'

Acknowledgements

This report draws extensively on *A Sterling Solution*, a report published by Stamp Out Poverty, in its 2nd edition in September 2006, and written by Dr Stephen Spratt, the Head of Research at Intelligence Capital Limited, an economic think-tank and financial advisory firm.

The report also draws heavily on several other existing and forthcoming publications on the financial markets by Sony Kapoor.

The authors would like to thank the members of the Leading Group, especially Norway, for their support.

Foreword

While this report examines an industry that is global and highly profitable, it is not anti-profit or anti-globalisation. That said, the banking sector's profitability and global nature is an important backdrop to this study. The global airline industry has a good year when profits reach \$2 billion. The global banking sector delivered \$100 billion of profit in 2005 – a substantial part of which is related to globalisation: the financing of trade and arranging of capital flows.

Today, government ability to raise national taxes is hampered by the globalisation of well-paid individuals and large corporations. At the same time, voters are demanding more global goods such as a clean environment and physical security. Consequently, we need to embrace global taxes that may in time replace national taxes. It would be odd if in doing so we end up taxing airlines but not banks. Separately, when considering how to finance initiatives that support those less positively affected by globalisation, it would seem fair that the main beneficiary of globalisation should make a contribution. Banks recognise this. They are involved in a number of initiatives to support education and community lending around the world. But these are often too small or diffuse to make more than a public relations impact.

Unsurprisingly, given the sector's size and profitability, it has one of the strongest lobbies. This lobby projects a view about the fragility and elusiveness of global finance that does not sit with today's reality of highly regulated banking institutions. But in their lobbying they are often supported by politicians who generally have a low level of understanding of finance and a high level of fear of doing anything that might jeopardise the jobs, taxes and political contributions of the sector. Some of you will know me as a former leading currency analyst and senior manager of currency trading businesses at JP Morgan and State Street and I have witnessed much of this at first hand.

It was with some apprehensiveness, however, that Intelligence Capital accepted the invitation to provide an objective and expert opinion on the feasibility of a unilateral currency levy. You never know where good research will take you until the end. I am now convinced that given the Basel Capital Adequacy Accord for internationally systemic banks, the Financial Action Task Force on money laundering and the new continuous linked, real-time settlements system for global foreign exchange, that a currency transaction development levy would now be relatively easy for any country to adopt, hard for any bank to evade and possible for most countries to implement unilaterally. I recommend this report to you.

By Avinash Persaud

President, Intelligence Capital Limited – former head of currency research at JP Morgan, UBS Philips and Drew and State Street Bank and former visiting scholar at the IMF.

Taking the next step

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David Hillman, Sony Kapoor and Stephen Spratt, December 2006

Commissioned by The Norwegian Ministry of Foreign Affairs (MFA).

This report represents the views of the authors and may not reflect the views of the MFA.

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Introduction

As we approach the half-way point for the achievement of many of the Millennium Development Goals (MDGs) the spotlight is shining ever more intently on the urgent need for new sources of revenue to pay for them. With the first international development duty launched, in the form of the 'pilot' solidarity levy on air travel, the momentum needs to continue to the implementation in quick succession of a second such initiative to provide another long term predictable source of additional finance.

Innovation is required not just in financing but also in delivery. UNITAID's mission is to transform a situation of high cost drugs for the treatment of the few to low cost drugs for the care of the many. In so doing its potential value is exponentially greater than a simple addition of extra revenue. The choice of how and where the next new stream of finance is spent also needs to be to be similarly strategic.

The Core Group¹ Governments rightly pride themselves on an international development policy that has, as one of its pillars, the tackling of **global inequality** which has risen rapidly in the latest phase of globalisation. For example President Chirac opened the Paris conference held in February 2006 in Paris stating that *'despite the continuous increase in global wealth, a third of humankind still lives on less than a euro a day'*, and that *'...globalisation, far from bridging the (poverty) gap, is widening it even further'*.

In this report, we offer some suggestions for tackling **global inequality** through concrete proposals for both raising substantial new revenue equitably and spending it in ways that strategically target the 'weak spots' in the international development effort.

The financial services industry has been one of the biggest beneficiaries of globalisation. Annual turnover in the global market for currencies, has, for instance, expanded from about \$4 trillion in 1973 to \$40 trillion in the mid 1980s to more than \$450 trillion now – a more than 100 fold increase.² Profits at financial services firms are also at a record high with the top two most profitable banks, Citibank and HSBC, posting more than \$40 billion of profits between them in 2005 alone.

At the same time as industries such as airlines and financial services have benefited from globalisation, populations in many of the poorest countries, especially those in sub-Saharan Africa, have been left behind – or worse, harmed. Average life expectancy in these countries is in fact down from 50 years in 1990 to 45 years now, just over half the almost 80-year life expectancy in countries such as Norway. The health, education and productivity problems caused by a lack of access to basics such as clean drinking water and sanitation facilities, the added decimation wrought by global pandemics such as HIV/AIDS on the ability of the populations and systems in poor countries to cope, and the increased vulnerability linked to climate change, all threaten to undermine and, in fact, roll back the slow progress that has been made to date towards meeting the MDGs.

¹ The Core Group: Brazil, Chile, France, Norway and the UK – the principal countries at the heart of progress with UNITAID.

² Bank for International Settlements (BIS) *Survey of Foreign Exchange Markets*

In Section 2 we demonstrate in some detail how, by introducing a very small levy of less than a hundredth of one per cent on currency transactions, many countries can unilaterally generate substantial resources for development from those who can most afford to pay. Such a levy is simple and inexpensive to apply in this age of electronic transfers. Whilst this proposal is specific to the currency market, it can be generalised to apply to other financial markets many of which already pay some form of a levy.

The possible uses for this revenue that we propose in Section 4 have been shaped by the need to lever maximum results from the resources generated. The three potential areas for immediate financing that we have identified would generate positive additional outcomes towards the achievement of several seemingly unrelated development goals. 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.

1 Progress and next steps: the general case for the Currency Transaction Development Levy

'If current trends persist, there is a risk that many of the poorest countries will not be able to meet many of [the Millennium Development Goals]. Considering how far we have come, such a failure would mark a tragically missed opportunity... As I said in my March report: let us be clear about the costs of missing this opportunity: millions of lives that could have been saved will be lost; many freedoms that could have been secured will be denied; and we shall inhabit a more dangerous and unstable world.'

Kofi Annan, UN Secretary-General, 2005.

Context

The 'Leading Group on Solidarity Levies to Fund Development' have followed an important principle that lies at the core of recent progress with the Air Ticket Levy. Broadly speaking, those most benefiting from globalisation can provide additional, long-term, predictable financing to those so dramatically left behind. Airlines and financial services have been amongst the biggest beneficiaries of globalisation, having grown exponentially in the last few decades. The poor, especially in the Least Developed Countries, have fared badly, with average income levels and life expectancy in most sub-Saharan African countries lower now than 25 years ago.

Progress – from words to action

One year ago innovative sources of development financing were aspirations. In the last few months alone UNITAID has been launched, swiftly followed by the International Financing Facility for Immunisation (IFFIm). Between them, these two 'pilot' initiatives will raise approximately \$1.3 billion in the forthcoming year to both treat and prevent disease. Reducing the price of drugs and rolling out huge inoculation programmes have the potential for wide impact in addressing the Millennium Development Goals (MDGs). It is clear, however, that to bridge the funding gap required to meet the MDGs, further complementary initiatives need to come on stream at the earliest opportunity. As we look to take the next step, it is important to concentrate on 'innovative' initiatives targeted at presently under-funded 'weak spots' in global development efforts.

The Currency Transaction Development Levy (CTDL) proposal and potential use of CTDL income

The proposal is for all foreign exchange (FX) transactions in a particular currency wherever they take place in the world to be subject to a development levy of 0.005%.

In respect of where income could be channelled, we have chosen to target three potential sectors:

- The provision of clean water and basic sanitation
- Greater funding for efforts to fight global pandemics and disease
- Provision of far greater support for poor countries affected by humanitarian emergencies.

Progress in these areas could have a significant knock-on effect in the achievement of a number of sometimes seemingly unrelated development goals, and provide progress on a number of fronts such as reducing child and maternal mortality, reducing poverty and hunger, increasing gender equality and increasing access to education.

The Leading Group and the MDGs

Since the MDGs were adopted in the year 2000, it has become increasingly clear that unless greater financial commitments were also made, the Goals would remain unrealised, condemning hundreds of millions to abject poverty, resulting in tens of millions of preventable deaths. It was the recognition that taking the ‘business as usual’ approach would mean the MDGs would not be realised, which galvanized many of the Leading group governments into action. *‘We are convinced that the Millennium Development Goals will simply not be achieved in many countries at present levels of aid flows.’*³

It was also recognised that progress on increasing traditional official development assistance (ODA) would in itself not be enough to address the problem. This led to a search for ‘innovative mechanisms’, which were explored in detail in both the Chirac commission (*Landau*) report and the *Action Against Hunger and Poverty* report, both published in 2004.⁴

Both reports emphasised the logic of transferring resources from the winners of globalisation to those who have been left behind and explored in some detail how implementing levies on the transport sector (such as air travel) and financial markets (such as currency markets) could help generate significant revenues and provide resources to make real progress on meeting development goals.

From the winners of globalisation to those who have been left behind

President Chirac addressing the first Leading Group conference in Paris in February 2006 stated that *‘despite the continuous increase in global wealth, a third of humankind still lives on less than a euro a day’*, and that *‘...globalisation, far from bridging the [poverty] gap, is widening it even further’*. Extreme inequality in the world is an undeniable phenomenon. Three hundred thousand of the most wealthy US citizens, less than 0.1% of the population, for example, earn more than one and a half billion poor people – a quarter of the world’s population.⁵ Almost 90% of the world’s wealth is now concentrated in the hands of less than 20% of its inhabitants.⁶

3 Declaration on Innovative Sources of Financing, September 14 2005, New York

4 *Landau* report: www.diplomatie.gouv.fr/actual/pdf/landau_report.pdf
Action Against Hunger and Poverty report, launched September 2004: www.diplomatie.gouv.fr/actual/pdf/Reportfieng.pdf

5 Authors’ estimate using data from the World Bank and *New York Times*.

6 *Capitalism’s Achilles Heel: dirty money and how to renew the free-market system* by Raymond Baker, Wiley (2005)

While globalisation has meant for example that the financial services industry (and the players in it) have grown from strength to strength commanding an increasing share of global wealth, it has also meant that many of the world's poorest and most vulnerable people – the least able to take advantage of globalisation – have been left behind. Worse, the 'economic adjustment costs' associated with globalisation have also increased deprivation resulting in a loss of livelihoods for many in some of the poorest countries.

Global pandemics, such as HIV/AIDS have thrived in this age of easy travel, multiplying spread of the disease. Additionally, hundreds of millions of people, especially those who live in low-lying or semi-arid poor countries, will increasingly find their way of life, or even the mere preservation of their lives, threatened by the onset of global warming and climate change. Those who have generally not benefited from globalisation are paying the price of the economic activity and large-scale emissions generated by the rich world at the expense of the poor.

It is for this reason that conversation concerning redistribution has been present in Leading Group discussions. It is also why imposing a levy on financial market trading has been one of the flagship proposals within both the *Landau* and *Action Against Hunger and Poverty* reports.

Taxing financial markets

'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.'

President Chirac of France, President Lula of Brazil, President Escobar of Chile and Prime Minister, Zapatero of Spain, from the *Action Against Hunger and Poverty* report.⁷

The enormous size of these markets means they have a large revenue potential

Turnover in the global market for currencies, has, for instance, 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 1993⁸ and the wealth held in the global bond market has increased more than three-fold to almost \$60 trillion now⁹ 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.

⁷ *Action Against Hunger and Poverty* report, launched September 2004: www.diplomatie.gouv.fr/actual/pdf/Reportfieng.pdf

⁸ World Federation of Exchanges

⁹ Bank for International Settlements, www.bis.org

Small transaction levies do not damage financial markets and are simple to implement

Applying small transaction levies, of the order of a few hundredths of one per cent, can raise vast sums of money, and because these transfers are carried out electronically, it makes implementation simple and each transaction traceable. Many such transaction taxes already operate successfully and raise billions of dollars of revenue for countries as varied as the UK and Brazil.

The existing transaction tax regimes show that financial markets are comfortably able to shoulder the burden of such levies especially when the rate is kept low. Liquidity and market structure are not affected adversely and income generation is predictable and stable in the long term.

Such levies are collected electronically at minimal cost, on average about 50 times less than the corresponding costs for the collection of income taxes. Once the collection has been plumbed into the electronic system it is automatic and very difficult to avoid.

Currency markets – principle reasons to implement a development levy

'A tax on foreign exchange transactions is technically feasible.'

President Chirac of France, President Lula of Brazil, President Escobar of Chile and Prime Minister, Zapatero of Spain, from the *Action Against Hunger and Poverty* report.¹⁰

The growth of profits

The financial services industry is responsible for the vast majority of currency transactions. It has seen record levels of profits with the top three banks earning more than \$50 billion between them in 2005. Profits on currency trading are not always disclosed separately but in 2003, the latest year for which figures are available, the same banks made almost \$5 billion from currency trading alone.¹¹ 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.

The incidence of the levy

Most transactions in the FX markets are conducted between banks themselves or with other large players in the financial services industry. Transactions with individuals (for overseas travel for example) constitute less than 0.1% of total transactions and trade-related transactions amount to less than 10%. A significant proportion of the tax burden is thus likely to be borne at least initially by the financial services industry itself with some of the costs being passed on to trade related transactions. The financial services industry is disproportionately used by the richer segments of the society so

¹⁰ *Action Against Hunger and Poverty* report, launched September 2004: www.diplomatie.gouv.fr/actual/pdf/Reportfieng.pdf

¹¹ FX Week, June 21st 2004

the tax incidence is likely to be socially progressive and is unlikely to affect the majority of the population in any tangible way. The incidence of the levy is discussed in greater detail later in the report.

Other taxes

Other financial markets such as stock markets and bond markets already pay a transaction levy in many countries. In the UK, for example, a 0.5% stamp duty is levied on the purchase of stocks. This generates substantial revenues of about \$7 billion every year. Countries such as Germany, Belgium and Switzerland tax bond transactions. Many countries in Latin America, such as Brazil, Colombia, Peru and Venezuela currently levy a generalised financial transaction tax. A stamp duty or levy on currency transactions is simply a natural extension to the financial transaction taxes that already exist.

Technical issues

The CTDL can be levied unilaterally on all FX transactions in a particular currency wherever they take place in the world. The levy can be collected in an inexpensive and efficient way at the point of transaction settlement through either the Continuous Linked Settlement Bank (CLS Bank) or the real time gross settlement mechanisms (RTGS) that are run for all major currencies by their respective central banks. The fact that all FX transactions are electronic makes collection cheaper and evasion very difficult. A levy that includes the euro will need a consensus from all euro area members. However, countries such as the UK, Switzerland, Sweden, Norway and Denmark could implement a CTDL unilaterally for little expense in cost, time and effort, if they so wished.

Quality not just quantity

Taxing financial transactions such as currency transactions to fund development is important not just in terms of the increase in quantity of money raised but also because of improvement in the quality of aid disbursed to poorest countries.

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. Thus taxing financial transactions for development could also help substantially increase the effectiveness of development aid.

The CTDL is not the Tobin tax but a solidarity levy

It is important to clarify that the levy that we are proposing on currency transactions is not the same as a Tobin tax, an idea with which it is often mixed up.

James Tobin's original 1970s idea was for a tax to alter motivation in the foreign exchange market. The purpose of his tax was to impede daily currency trading¹² and to discourage speculative activity. When he advanced his proposal the currency market had a daily value of \$18 billion, it is now worth almost \$2,000 billion per day. The rate he proposed was 1%, 200 times the 0.005% rate set out here, and the income was not designated to a specific purpose, such as development. Tobin was actively seeking to alter the structure of the market through the imposition of such a tax.

The Currency Transaction Development Levy (CTDL), the focus of this report, is entirely different. Its *raison d'être* is as a financing instrument for development. Its rate is designed specifically not to hamper normal market operations but instead to skim a tiny fraction of the volume traded. The two proposals have but one element in common, they are both associated with currency. The CTDL 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.

The CTDL – an ideal levy

The CTDL is an ideal levy providing a substantial long term, predictable income stream from a financial market, which is not just the largest in the world but has grown exponentially with the advent of globalisation and continues to do so. This revenue can be raised cheaply with little risk of avoidance and without altering the structure and operation of the market. Resources can be used to address the weak spots in the architecture of meeting the Millennium Development Goals. This offers some redress to the imbalance of globalisation by having its winners contribute to those that have not been so fortunate.

¹² His intention was to 'throw sand in the wheels of our excessively efficient international money markets'. Professor James Tobin (1978) 'A Proposal for Monetary Reform', *Eastern Economic Journal*, based on Janeway Lectures, Princeton, 1972.

2 Implementing a Currency Transaction Development Levy

Financial Transaction Taxes (FTTs)

Taxes on financial transactions, such as taxes on share trading, bond trading, house purchases or bank debits have a long history and most have operated successfully for many years raising substantial amounts of revenue with no apparent negative impact on the market. In fact all of the G10 countries except Canada have levied financial transaction taxes at some time. Of these, the United States¹³, UK, France, Belgium and Switzerland have existing FTT regimes. The other G10 members have (relatively recently) dismantled FTTs they had: Japan (1999), Italy (1998), Sweden and Germany (1991) and the Netherlands (1990).

However, while there has been some movement towards the removal/reduction of transaction taxes, this is counterbalanced by recently imposed FTT regimes in India (2004), Peru (2003), Argentina and Colombia (2000), Ecuador (1999), Greece (1998) and Finland (1997). In fact, Greece doubled its transaction tax on share trading in 1999. The table in the Appendix provides a more comprehensive list of various financial transaction taxes.

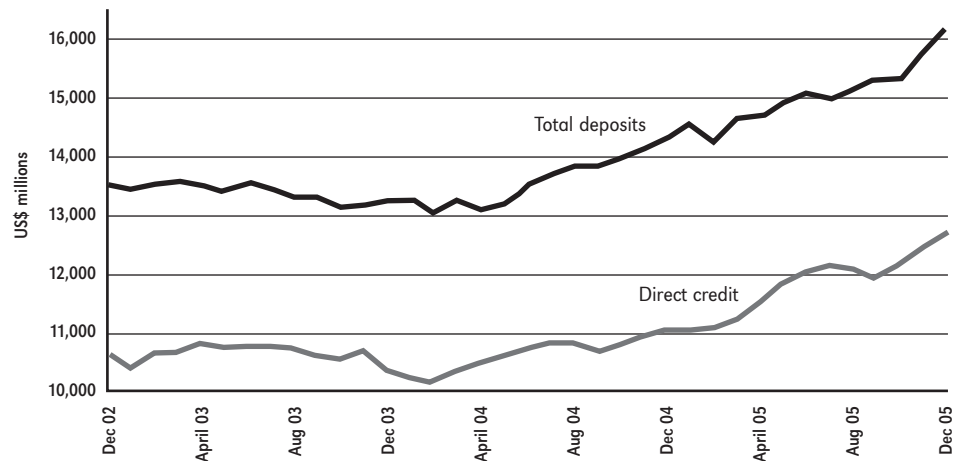
Common objections to the introduction of financial transaction taxes are that they will: a) distort the market and b) drive investors/financiers out of the economy or sector to other, untaxed economies. The reality, however, is often very different. In the UK, for example, a stamp duty on share transactions generates as much as \$7 billion every year – at a collection cost that is 50 times cheaper than the cost for collecting income tax. Despite having this 0.5% (50 basis points) stamp duty on share transactions, the UK continues to be one of the top financial centres and the London Stock Exchange one of the premier exchanges in the world.

In 2003 the Peruvian government introduced a 0.1% general financial transaction tax, with the aim of raising finance for the education sector. At this time, the national and international financial press, concerned private investors and international financial institutions such as the IMF predicted severe negative consequences to the Peruvian 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. Figure 1 overleaf illustrates what actually happened.

13 In the US, Security transaction taxes apply to transactions in publicly traded shares and exchange traded futures and options and the revenue raised is used to cover the cost of the operations of financial regulators such as the Securities and Exchange Commission (SEC).

FIGURE 1
Bank deposit and credit levels following Peru's introduction of a financial transaction tax in 2003

Source: Superintendencia de Banca y Seguros, Lima. December, 2005



As can be seen, far from reducing bank deposits and therefore credit, the period following the introduction of the financial transaction tax saw both bank deposits and access to credit increase steadily.

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 rate at which these taxes are levied are many multiples of the CTDL rate 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 in different countries, at different times.¹⁴

In summary, here are some key elements of FTTs:

- It is not unusual for financial transactions to be taxed in some form or other – this ranges from the duty on share trades in the UK, the tax on corporate bond trading in Germany and the generalised levy on financial transactions in Peru
- Where FTTs have been levied, financial markets have generally adopted them with no major repercussions
- FTTs raise substantial amounts of revenue
- In most cases, this income is collected electronically at the point of settlement with minimum cost to the governments
- Evasion has not proved a serious problem.

One of the key points that emerge from this discussion is that the foreign exchange market is unusual for not yet being taxed. Given that it is the largest financial market in the world, a levy on foreign exchange trading would be expected to raise substantial amounts of revenue provided a suitable collection mechanism could be designed at the point of trade settlement. With the tax designed at an appropriate low rate it would not have an adverse impact on the day to day operation of the market. The income could

¹⁴ *Bank Debit Taxes in Latin America: an analysis of recent trends*, IMF Working Paper 67 (2001)

then be mobilised to such ends as the implementing government(s) should wish, such as international development.

We present here a proposal for countries to unilaterally implement a very small levy on currency transactions and collect the proceeds using existing systems of electronic settlement.

Our Currency Transaction Development Levy proposal

The proposal is for all foreign exchange transactions in a particular currency wherever they take place in the world to be subject to a levy of 0.005%. The past two decades have seen significant changes in the way FX transactions are settled both nationally using Real Time Gross Settlement systems and internationally using the Continuous Linked Settlement (CLS) Bank (see Box 2: International payment and settlement systems).

Therefore, whilst Central Banks have responsibility for ensuring the effective functioning of systemically important country-based payments systems, a country is not an island in this respect. Rather, it operates in an interconnected – and interdependent – global network of central banks and national payment systems, and cooperates in the oversight of cross-border payment systems, such as the CLS Bank.

These developments have today made a unilaterally implemented CTDL feasible. A leading scholar in this field is Professor Rodney Schmidt, who put the issue as follows in the year 2000:

*'...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.'*¹⁵

BOX 1

The importance of the settlement system and central bank role in Norway

*'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.'*¹⁶

¹⁵ Schmidt (2000)

¹⁶ Norges Bank's oversight and supervision of the payment system, *Norges Bank Economic Bulletin* 2002 Q1 (2002)

BOX 2**International payment and settlement systems**

The last two decades have seen significant changes in the practice of payments and settlement systems globally. As overseeing authorities have sought to reduce settlement risk and enhance systemic efficiency, Deferred Net Settlement (DNS) systems have given way to Real Time Gross Settlement (RTGS) systems, where – at least domestically – settlement risk is effectively eliminated due to the use of payment versus payment (PvP) and delivery versus payment (DvP). In general terms, advances in IT have led to greater uniformity, as heterodox forms have gradually been replaced by a more homogenous approach based on commonly used technical platforms, thereby greatly reducing costs through increased efficiency. Major Large Value Payment Systems (LVPS) in developed countries are increasingly interdependent. They rely on the same technological infrastructures, which ensure that this interdependence functions smoothly and effectively.

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. While the Norges Bank, Bank of England and the European Central Bank do not oversee SWIFT's activities separately, they lend support to the oversight carried out by the Belgian central bank under the auspices of the G10 group in the Bank for International Settlements.¹⁷

For the purpose of this report it is important to understand how currency settlement operates. In the UK, for example, the Clearing House Automated Payment System (CHAPS) is a key body in this regard. CHAPS is the organisation through which most high-value wholesale payments are processed, and it operates an RTGS system. Sterling currency transactions are settled either through CHAPS or the Continuous Linked Settlement (CLS) Bank.

The Norwegian equivalent is the Norges Bank's (the Central Bank of Norway) own settlement system, NBO. The Norges bank has also authorised two other payment and settlement systems – DnB NOR Bank ASA and Norwegian Interbank Clearing System (NICS) – but these settle smaller amounts and, in fact, operate under the supervision of the central bank.

For the settlement of large value euro transactions the European Central Bank (ECB) operates the TARGET system which interlinks the national level RTGS systems of the euro area's 15 countries to provide automated settlement. This was designed to provide common procedures – especially messaging functions which allow payment orders (for settlement) to move seamlessly between the national level RTGS systems.

FX related euro transactions are mostly settled through the CLS or the TARGET systems and in the case of the Norwegian krone through the NBO or through the CLS.

Internationally, cross-border FX Herstatt¹⁸ Risk – one of the last remaining outposts of settlement risk in the global financial sector – has also been addressed with the launch of the CLS Bank, which enables FX transactions in different time-zones to be settled on a PvP basis. As with national Large Value Payment Systems, this effectively eliminates settlement risk.

17 Annual Report on Payment Systems 2005, Norges Bank (May 2006), and Bank for International Settlements

18 On 26th June 1974 at 15:30 CET, the German authorities closed Bankhaus Herstatt, a middle-sized bank with a large FX business. Prior to the closure, however, a number of Herstatt's counterparty banks had irrevocably paid Deutsche marks into Herstatt but, as US financial markets had just opened, had not yet received their dollar payments in return. This failure triggered a ripple effect through global payment and settlement systems, particularly in New York. Ultimately, this fed into New York's multilateral netting system, which over the following three days, saw net payments going through the system decline by 60% (BIS 2002). This settlement risk became known as Herstatt Risk and has been addressed by the development of Real Time Gross Settlement (RTGS) systems and the recent introduction of the Continuous Linked Settlement (CLS) Bank.

To be effective a CTDL would need to have the following attributes:

- 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.

Below we explain in some detail how such a CTDL would work using examples of the UK sterling and Norwegian krone, and also how the proposal meets each of these three criteria.

Implementing a CTDL

Since the launch of the CLS Bank in 2002, a growing share of FX transactions have migrated to it. Today it is estimated that a little over 60% of all global sterling, krone and euro trades are conducted through the CLS system.¹⁹ Of the remainder, the overwhelming majority are processed through the UK's CHAPS, the Norges Banks' NBO and the ECB's TARGET System for their respective currencies. These currency specific systems are therefore directly connected to the CLS member banks, and through this link also connected with the other major national RTGS systems.

To be effective, therefore, the CTDL must be implemented at a number of levels. The most straightforward of these is through the CLS Bank. As pointed out above, more than 60% of all sterling, krone and euro transactions are settled in the CLS system, where it would be a straightforward task to identify them. For example, the UK Treasury has accepted the validity of this point, not least because it would be practically straightforward and that, if implemented in the UK, would have to be adhered to by the CLS Bank.

*'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.'*²⁰

Having accounted for more than 60% of all sterling, krone and euro FX trades, the CTDL must also address the remainder – though, as described above, this 'remainder' is likely to become an ever-smaller proportion in the years ahead. By far the most important organisations, in this regard, are the LVPS – CHAPS, NBO and TARGET for each of the three regions specifically. Here, the developments in the LVPS sector are key to the feasibility of implementing an effective CTDL.

How would the CTDL be raised in practice?

In Norway, for example, we can imagine a situation where NorwayBank1 wishes to purchase a Norwegian financial asset from NorwayBank2. If the sale price is agreed, NorwayBank1 sends a SWIFTNet message to the relevant LVPS with an instruction to debit its settlement account at the Norges Bank, and to credit the settlement account

¹⁹ CLS Issue Brief October 2006, assuming that the CLS settles the same proportion of trades in all currencies.

²⁰ HM Treasury (2004), written response to points raised by Stamp Out Poverty

of NorwayBank2. At the same time, NorwayBank2 sends a SWIFT message requesting ownership of the relevant asset be transferred to NorwayBank1. SWIFT then matches the two messages, and after requesting and receiving confirmation from both banks, transfers both the krone amount and the ownership of the asset. In this instance, both sides of the transaction are in krone and therefore represent a domestic transaction that does not attract the CTDL.²¹

Internationally, however, the situation is rather different. Suppose NorwayBank1 wishes to buy US dollars for krone. NorwayBank1 makes an offer to USBank1 (through any of a number of possible channels) and the offer is accepted. As with the domestic example, NorwayBank1 then sends a SWIFT message to the LVPS requesting it to debit its settlement account at the Norges Bank for the appropriate quantity of krone, and to credit the account of NorwayBank2 at the central bank (we assume that USBank1 keeps its krone holdings with an account at NorwayBank2 as an escrow account, which reflects standard international banking practice). At the same time, USBank1 sends a message to its LVPS requesting that the appropriate dollar amount is transferred from its balance to that of USBank2 (again, we assume that NorwayBank1 keeps its US dollar holdings in an account with USBank2).

In Norway, SWIFT requests confirmation of the trade from NorwayBank1, upon receipt of which it debits NorwayBank1's account at the Norges Bank, and credits that for NorwayBank2. Unlike the domestic transaction, however, it is unable to match the message from NorwayBank1 to another krone-based message in the system. Therefore, although domestically the PvP process requires matching of trades and removes settlement risk, an international FX trade cannot be settled on a PvP basis in a national system such as NBO, as each leg of the trade takes place in different domestic LVPS, often operating in different time-zones. It is this failure to match both legs of a transaction in krone that identifies the transaction as an FX trade, upon which the CTDL can be levied.

In this way a CTDL could feasibly be implemented unilaterally in Norway, with the overwhelming majority of krone transactions undertaken globally being identified through the CLS system and the NBO. As the stylised example above makes clear, this is based on PvP systems in domestic LVPS, as well as the PvP approach employed by the CLS Bank. The 'oil' that lubricates this process and makes it possible, however, is the ubiquity of standardised messaging formats within the financial sector.

A key feature of the various interlinked systems through which FX transactions can be settled is their use of the SWIFTNet messaging system. Importantly, SWIFT also provides messaging services for major electronic FX trading platforms such as FXall, as well as for the major global bilateral and multilateral FX netting systems, past and present. This global reach offers the chance to further extend the scope of the CTDL, and ensure that all FX related sterling trades in CHAPS, krone trades in NBO, and euro trades in TARGET, are identified.

Within each of the systems in which it operates, SWIFTNet provides secure payment messaging between members through its FIN system and, crucially, has a dedicated message form – the MT300 – which is used to confirm individual FX trades. That is, whether in the CLS system, CHAPS, NBO, TARGET, FXall or a multilateral netting

²¹ This stylised example is an adaptation of that used in Schmidt (2001).

system, an FX trade is confirmed between the counterparties by means of a SWIFTNet FIN MT300 message, or one of its variants.

The MT300 message is initially exchanged by or on behalf of the parties that have agreed to a foreign exchange contract. The fact that MT300 messages also provide notification of amendments to contracts and cancellations of previously held confirmation is important for the purposes of this proposal, as it ensures that the CTDL is only levied on sterling, krone or euro FX transactions in the form in which they are ultimately transacted. Also, because MT300 messages confirm individual FX trades, they precede any subsequent bilateral netting process that may occur, after which identifying the individual trades concerned may not be possible.

Within each MT300 message, a number of fields must be completed. For an FX trade, the currencies concerned and the amounts bought and sold are included here. In the Mandatory Subsequence sections of the MT300 message, the relevant sections are B1 (Tag 32b) for the currency and amount bought, and B2 (Tag 33b) for the currency and amount sold. Consequently, all the information needed to identify sterling, krone or euro transactions is already in place. No dedicated infrastructure is required.

The MT300 messaging system can therefore capture the lion's share of sterling, krone or euro transactions in the 'traditional' FX market. However, this still leaves the area of the OTC derivatives market. In one important respect, this market is also covered by the MT300 messaging series, which is used to confirm that FX options have been executed. In this case, MT305 and MT306 are used as messaging formats. All other FX OTC derivative contracts are contained within the third category of SWIFTStandard messaging formats, which range from MT300 to MT341 and from MT350 to MT399. As with the traditional market, messages require the currency, amount and counterparties to be identified within the message, as well as the facility to amend or cancel contracts.

The next piece of 'plumbing' is to gather relevant messages of this form in a central location, to enable the CTDL to be levied. Again, however, it is possible to 'piggy-back' upon existing networks by using the SWIFTNet FIN Copy messaging function. The majority of recipients of SWIFT FIN Copy messages are central banks, as the messages facilitate settlement in the centralised RTGS systems. The ideal template is FINInform, where copied messages are triggered to the central bank depending on either the identity of the parties or the type of message sent.

A key aspect of the proposal is therefore to establish a SWIFTInform messaging service, which is triggered by the sending of an MT300–MT399 FX message, in either the traditional or the OTC derivatives market. In this instance, a copy of parts of the message – currency, volume and counterparties – is automatically sent to, for example, the Bank of England for every FX transaction involving sterling. As with all aspects of the proposal, this process would be automated and would require no dedicated infrastructure. The next section deals with how the CTDL would be collected with the help of the information gathered.

The following diagrams use the example of sterling transactions to highlight how the CTDL would be executed in practice based on existing settlement infrastructure.

FIGURE 2
The global sterling payment and settlement system

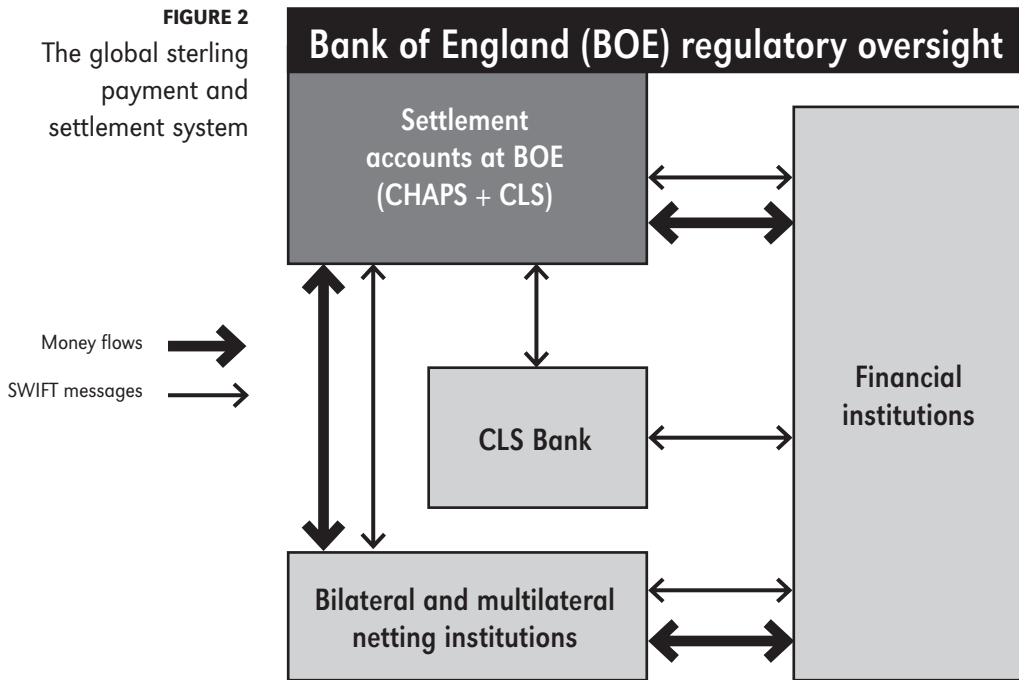
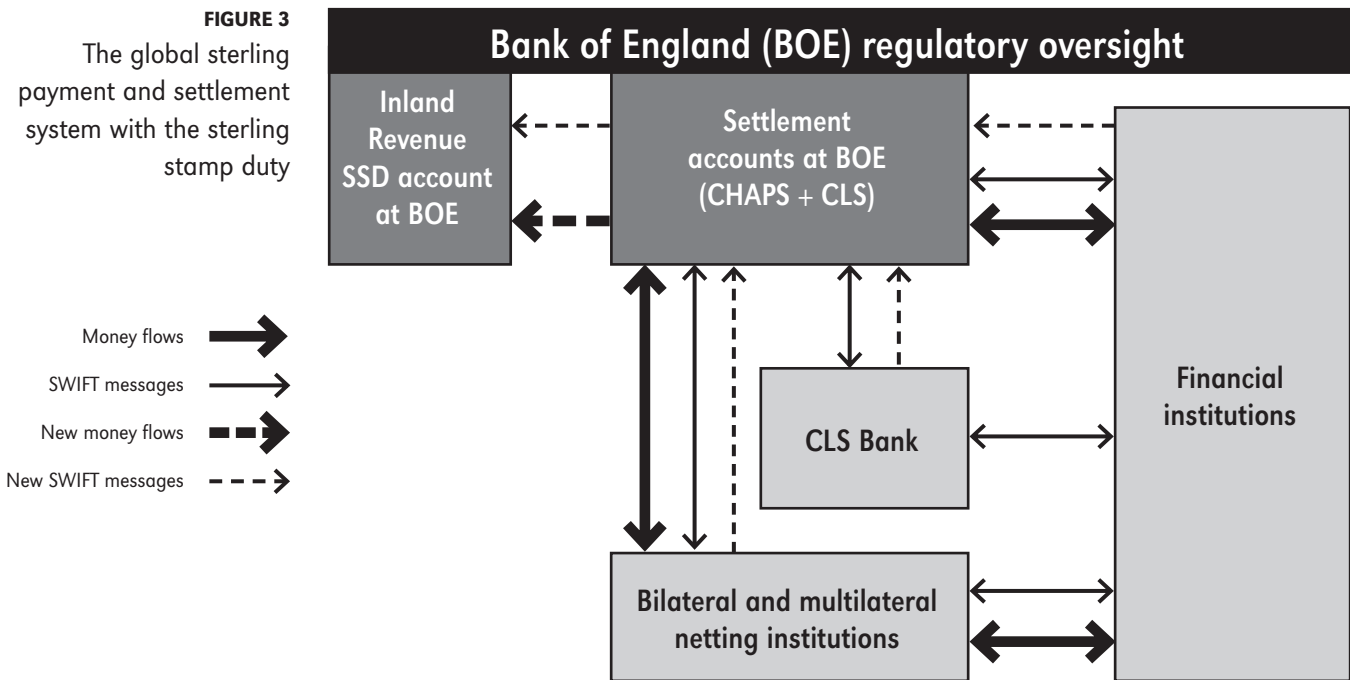


FIGURE 3
The global sterling payment and settlement system with the sterling stamp duty



Collecting the CTDL and preventing avoidance

Once identified in the manner described above, collecting the CTDL would be a relatively straightforward process. To be able to participate in the CLS system, financial institutions must hold an account with the CLS Bank. However, in practice, UK-based CLS Bank members actually hold their accounts within the Bank of England, Norway-based members with the Norges Bank and euro area members with their respective central banks. These accounts can then be credited and debited by the institution in accordance with their liquidity requirements for CLS Bank. To collect the CTDL from the CLS system, therefore, the levy could be directly taken from the relevant accounts.

Similarly, in order to be a member of CHAPS, NBO or euro area RTGS systems, a financial institution must hold a settlement account at the respective central bank. Therefore, once the tax to be paid is identified and traced to the RTGS member, it can be transferred from the relevant settlement account held at the central bank to the account of the finance ministry also held at the central bank.

The SWIFT messaging system in general, and the FINInform Copying function in particular, is completely automated on a day-to-day basis. Consequently, though the relevant systems would have to be slightly modified to facilitate tax identification and tax-take from the appropriate centrally held accounts, the changes would be relatively minor. Furthermore, once the fixed, start-up costs were met, the marginal cost of operating the system would be very low.

Direct members of both the CLS System and country-level LVPS are relatively few in number, with a significant proportion of all trades being undertaken by members on behalf of their third-party customers. Whilst these market participants would not be directly taxed, they would be affected by the CTDL, which would be directly reflected in the spread charged them by the CLS Bank/CHAPS/NBO/other RTGS members in exchange for executing their FX business.

The remaining sterling, krone or euro trades undertaken – by corporations, for example – would still be identified by use of the SWIFTNet messaging service described. Furthermore, these trades would be settled by correspondent banks on behalf of the underlying corporate. These correspondent banks would hold accounts with the respective central banks, the CLS Bank, or both. Consequently, such FX trades would ultimately also incur the CTDL.

Running costs

On average SWIFT messages cost approximately £0.067 (0.82 krone or 0.1 euro) each. The CLS Bank settles 200,000 transactions a day, which is more than half of all FX trades. To capture the entire FX market, therefore, would equate to about 400,000 messages a day. The following table lists some of the estimated costs for implementing SWIFT copy messaging for the three currencies under discussion.²²

22 It assumes that the total running costs for the respective central banks (including setting up their own systems) would be on average two to three times the amount that it would cost to generate the additional SWIFT copy messages.

TABLE 1
Estimated costs for
implementing SWIFT
copy messaging

	GBP market	NOK market	Euro market
SWIFT transactions daily average	\$67,600	\$5,600	\$148,800
Additional copy messages annual cost	\$1.178mn	\$1.190mn	\$3.888mn
Approx total annual costs	\$2–3mn	\$2–3mn	\$8–12mn

Having established the feasibility of a) identifying FX transactions, and b) collecting the CTDL, the final question relates to the appropriate level at which to set the levy. The objective is not to maximise income per se, but to strike a balance between raising sufficient revenue to make a contribution to meeting the MDGs, and avoiding market distortions.

In 2004, the sterling, krone and euro accounted respectively for 8.5%, 0.7% and 18.6% of all FX trades globally, out of an average daily total of \$1,880 billion. This equates to a potentially taxable daily total of around \$160 billion, \$13 billion and \$350 billion for the three currencies respectively.

The table below illustrates the potential annual revenue from differing CTDL rates assuming 260 trading days in the year.²³

TABLE 2
Estimates of potential
annual revenue
generated at various
tax rates

SSD rate	GBP market	NOK market	Euro market
1%	\$415.48bn	\$34.22bn	\$909.17bn
0.1%	\$41.55bn	\$3.42bn	\$90.92bn
0.01%	\$4.15bn	\$0.34bn	\$9.09bn
0.005%	\$2.08bn	\$0.17bn	\$4.55bn

As can be seen, a 1% tax could hypothetically raise hundreds (or tens) of billions. However, a CTDL at such a level would certainly have a distorting effect on the market, reducing volumes traded drastically. At the 0.10% level the annual revenue would still, theoretically, be substantial. However, it is likely that a 10 basis points (bp) tax rate would also have a sizeable impact on the market as the typical market spreads (differences between the sale and purchase price) are below this level. In particular, it may provide a disincentive to trade, with the result that transaction volumes could fall, with the income from the levy therefore also falling by the equivalent amount.

A more realistic rate at which to set the CTDL would be 0.01%, or 1 basis point, where annual revenues would be in the order of \$4.15 billion, \$34 billion and \$9.09 billion for the sterling, krone and euro, respectively. While it is likely that a 1 basis point CTDL would not cause major disruptions in the respective currency market, this rate is not proposed. Rather, the proposal is to set the CTDL at half of one basis point: 0.005%. At this low rate, it is difficult to argue that the tax would distort the market. It would, however, still raise substantial amounts of revenue.

²³ These revenue estimates are highly conservative and based only on the turnover in the traditional FX market which was reported by the BIS to be \$1,880 billion per day. The OTC derivatives market is worth \$2,410 billion per day and the exchange traded FX product market is worth \$4,657 billion per day. Including these markets can potentially treble the revenue estimates.

Based on a conservative assumption we, therefore, estimate that the CTDL would produce annual revenues of \$2.08 billion, \$170 million and \$4.55 billion, for the UK, Norway and the Eurozone region, respectively. Of course, this assumes that the implementation of the CTDL has no impact upon volume traded. Given the extremely low level of the tax, this is not an unreasonable assumption. However, in order to err on the side of caution, we assume a 2.5% reduction in the volume of currencies traded, and this would amount to an annual receipt of \$2.03 billion, \$167 million and \$4.43 billion. The 2.5% figure is based on a report written for the UN on the revenue raising potential of currency transaction taxes (Nissanke, 2003).^{24,25}

As with other taxes, the respective tax authorities would be the agency with statutory power to collect the CTDL. The mechanics of collection, however, would be greatly eased by taxable funds being held in accounts at the central banks. For example, in the UK, it is already possible to pay taxes through the CHAPS system, which suggests that the simplest method of collection would be for the tax to be paid directly into a dedicated revenue authority CHAPS account, also held at the Bank of England and have equivalent arrangements in the case of other currencies.

In this entire discussion we have chosen to be highly conservative by focusing only on the traditional market and ignoring the OTC derivative market to arrive at our estimates of potential revenue. This market trades \$2,317 billion worth of currencies every day, a sum even larger than the traditional market. As seen from the discussion earlier in this section, implementing a levy on this market is no more complicated than implementing it for the traditional market. Hence, assuming that the proportion of traditional and OTC trades in a particular currency are roughly similar, the actual potential revenue available from a 0.005% levy on sterling, krone and euro transactions is at least double the amount we have calculated thus far.

Economic footprint

The 'economic footprint' of the CTDL would, in the first instance, fall upon the large financial institutions that are members of the CLS Bank and RTGS system's such as NBO and CHAPS. These are primarily international banks and the largest domestic banks. If this was as far as the process went, there is little doubt that major international banks could comfortably absorb this as shown by Tables 3 and 4 overleaf.

Large international banks dominate the global FX market. Together with the large domestic financial institutions in the respective currency areas, these institutions account for the vast majority of the FX trades in all currencies including sterling, krone and euro. These banks' trades are ultimately undertaken for a wide range of clients – for example, the CLS Bank estimate that an average of 200,000 separate transactions are settled every day, which gives some sense of the number of ultimate participants in the global FX market.

Let us briefly examine the general incidence and impact on corporations of a CTDL on sterling. As we have seen, the CLS bank processes an average of 200,000 FX transactions every day. In line with the global picture, we assume that 17.5% of these have sterling on one side of the trade, which gives 34,000 sterling transactions in

24 Some of the fall in volume could reflect a migration to stock exchanges, where FX deals can be executed by trading stocks denominated in different currencies. This practice already occurs to some extent, though its potential growth is limited. However, traded stocks are also settled in centralised systems of the kind described in this report, and could therefore be brought within the ambit of the CTDL relatively easily.

25 More clarity will be gained on this issue, when Professor Rodney Schmidt's ongoing research into the price elasticities of FX volumes is published.

TABLE 3
2005 profits for major
international banks ²⁶

Bank	Annual profit 2005
Citigroup	\$25bn
HSBC	\$16bn
UBS	\$11bn
JP Morgan Chase	\$8bn
Barclays	\$7bn
Goldman Sachs	\$6bn
ABN Amro	\$5bn
Merrill Lynch	\$5bn
Morgan Stanley	\$5bn
Deutsche Bank	\$4bn

TABLE 4
2005 profits for major
banks in Norway ²⁷

Bank	Annual profit 2005
Nordea	\$4bn
DnB NOR	\$2bn
Handelsbanken	\$2bn
Skandinaviska	\$1bn

the CLS system per day. However, the CLS Bank settles only around half of all FX transactions, which suggests a global figure of 68,000 sterling trades per day. Over a year, therefore, we can estimate the total number of sterling transactions to be of the order of 17.7 million. The impact of the CTDL would be spread very widely internationally with tens of thousands of participants carrying out the 17.7 million transactions. The cost would be in the region of \$117 per trade, on an average trade size of a little over \$2 million.

For corporations, however, the situation is clearly different. For example, the UK exports somewhere in the region of \$380 billion worth of goods and services per year. Based on the profit margins of UK companies from 1990 to 2002, we assume an average margin of 10%.²⁸ Ten per cent of \$380 billion is \$38 billion, which we take as a rough estimate of the annual profit of the UK's export sector. The impact of the CTDL on UK corporates would be somewhere in the region of \$115 million. Consequently, the impact on UK exporters would be just 0.3% of their annual profits, which is very small when set against the many other factors that influence company profitability. For example, over the past ten years, UK companies' average profitability has fluctuated by up to 10% per year. It is therefore clearly the case that when compared to the impact of changes to general business conditions, and movements in indicators such as interest rates and the sterling exchange rate, a CTDL of 0.005% will have hardly any discernable impact. This analysis is also applicable to the impact of the CTDL on the euro and the krone.

²⁶ US banks' data: http://money.cnn.com/magazines/fortune/fortune500/full_list/index.html

Non-US banks' data: each institution's consolidated financial statements 2005. US Dollar figures for non-US banks converted at exchange rate of 3/1/2006 – rounded figures.

²⁷ Annual statements of major global banks and Norwegian banks – rounded figures.

²⁸ See Citron and Walton (2002)

Consequently, we estimate that at least half of the impact of the CTDL will eventually be passed on by banks to their global clients in the form of a slightly higher spread. The impact of the CTDL would therefore be dispersed widely throughout the global financial system, and not fall disproportionately on any single institution.

Conclusion

To summarise, we have seen how developments in international payment and settlement systems, have resulted in an interrelated global network, which is lubricated by common technological and communication systems. It is precisely this highly interdependent network that makes it feasible today to unilaterally implement a CTDL on any currency. In order to avoid producing market distortions, the proposal is that the duty be set at a rate of 0.005% on all FX transactions of a specific currency. As well, the mechanism through which the CTDL could be efficiently identified and collected has been demonstrated.

We have produced highly conservative estimates of the likely annual revenue that would be raised through the CTDL based on unilateral implementation by the UK: \$2.07 billion, Norway: \$170 million and the euro area: \$4.3 billion. When compared with the estimated running costs of the system, it is clear that the cost of administration and collection of the duty would be minimal, maximising the amount available for international development purposes.

Finally, we have shown that for financial institutions that would be effected by the CTDL, the impact would be highly diffused throughout the financial system – both domestically and overseas – and would amount to, for example in the UK, just \$117 on an average FX trade of \$2 million.

For the corporate export sector, again in the UK, we see a similarly modest impact of 0.3% of average annual profits of 10%. Clearly both the financial and non-financial private sector could comfortably absorb the impact of the CTDL at the rate proposed, as do comparable institutions in other countries and regions.

3 Responding to objections

In this section we start with the two most standard criticisms of proposals to tax currency transactions, then describe why the CTDL is entirely different from the Tobin tax, before answering most commonly raised points of issue.

The two classic 'avoidance' criticisms

- Unless every country implements a CTT at the same time the currency trade would re-locate to **avoid paying the levy**. (The so-called **multilateral** argument has for many years been used to block progress on this issue and it is important that it is dealt with first).
- Even if the CTT could not be avoided through re-location of the trade an adapted or new foreign exchange instrument would be employed to **circumvent payment**.

The proposed CTDL overcomes these obstacles and many historical issues for the following two principle reasons:

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. This is a critical distinction. This is it the key to feasibility not least because it allows unilateral progress by one country or a group of like-minded countries. It works because (as indicated by the Norges bank report in Box 1, in the previous section) 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. The payment of a CTDL would be a legal obligation, like payment of any other tax. To avoid it risks an institution's reputation not warranted for the sake of paying a very small levy. (This is expanded upon below).

The proposed rate of the CTDL is 200 times smaller than the original CTT proposal. This is clearly a key factor with an array of consequences affecting many of the historical concerns traditionally pitted against it. 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.

The CTDL is not the Tobin tax

James Tobin's original 1970s idea was for a tax to alter motivation in the foreign exchange market. The purpose of his tax was to impede daily currency trading²⁹ and to discourage speculative activity. When he advanced his proposal the currency market had a daily value of \$18 billion, it is now worth almost \$2,000 billion per day. The rate he proposed was 1%, 200 times the 0.005% rate set out here, and the income was not designated to a specific purpose, such as development.

29 His intention was to 'throw sand in the wheels of our excessively efficient international money markets'. Professor James Tobin (1978) 'A Proposal for Monetary Reform', *Eastern Economic Journal*, based on Janeway Lectures, Princeton, 1972.

The CTDL is entirely different. Its *raison d'être* is as a financing instrument for development. Its rate is designed specifically not to hamper normal market operations but instead to skim a tiny fraction of the volume traded. The two proposals have but one element in common, they are both associated with currency. The CTDL 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.

Historical points of issue

Would financial actors get around a CTDL by inventing new FX instruments or shifting their currency trading to offshore tax havens and other non-taxed jurisdictions?

Contrary to what critics say, incentive for avoidance of a CTDL levied on a currency (as opposed to the jurisdiction in which a currency trade takes place) is very limited. Incentive to circumvent the CTDL (or any tax) is to a large extent based on the level of the tax. Banks and other financial institutions will weigh the potential cost of evasion (penalty, suspension of licence, reputation risk and the actual technical costs of evasion through new legal entities and new instruments) against the costs of compliance (a tiny fraction of their total profits or a fractional increase in costs charged to a client). At the very low rate of 0.005% the incentive to get around the levy would seem to be very small, with the costs of avoidance appearing much higher than the cost of compliance.

The scope for avoiding the CTDL by using new instruments is also very limited. In our proposal we suggest that the CTDL be levied on all transactions regardless of their type and duration. There is little scope for using exotic financial instruments as each type of foreign exchange instrument serves a unique function and finding a perfect substitute that is not subject to the levy would be difficult. Even if inventive measures were taken to get around the CTDL, tax regimes in a country are not static. The collection of taxes, such as income tax, is a cat and mouse game in which tax payers constantly try and pay as little as possible and the tax authorities try to collect as much as possible. Moves to circumvent tax regulation can be countered by authorities keeping a watch on market developments. 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. What is required is the political will to implement the CTDL and provide the necessary legal enforcement to ensure payment and penalise avoidance.

The scope for avoiding the levy by relocating is also limited as under our proposal the CTDL would apply to currencies, not jurisdictions. 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 levy can be collected, therefore, regardless of the geography of the trade.

Whilst it may have been the case in the past that a CTDL could not be implemented unilaterally, this is no longer so. Historically, the global foreign exchange market has consisted of disparate parts with little or no links between them. Trades were executed manually by phone between counterparties, and settled through a variety of systems with few linkages between them. 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 all of which are closely supervised and monitored by regulators.

***Economic incidence: who pays the CTDL? How spread is the incidence?
Would the levy change market operation?***

Although relatively few in number, large international banks dominate the global FX market. The 'economic footprint' of the CTDL would, in the first instance, fall upon these large financial institutions that are members of the CLS Bank and the Real Time Gross Settlement systems (RTGS). There is little doubt that they could comfortably absorb the levy given the size of their profits, however, they will as far as possible pass on these costs to their wide range of clients in the form of a slightly higher spread. The CLS Bank estimates that it settles an average of 200,000 separate transactions (about half of the global total) every day, which gives some sense of the number of ultimate participants in the global FX market. The impact of the CTDL on a specific currency would therefore be dispersed widely throughout the global financial system, with minimal impact on any one institution.

In further addressing this point we will use the example of a 0.005% CTDL on sterling. As discussed, the CLS bank processes an average of 200,000 FX transactions every day. In line with the global picture, we assume that 17.5% of these have sterling on one side of the trade, which gives 34,000 sterling transactions in the CLS system per day. However, the CLS Bank settles only around half of all FX transactions, which suggests a global figure of 68,000 sterling trades per day. Over a year, therefore, we can estimate the total number of sterling transactions as being somewhere in the order of 17.7 million carried out by tens of thousands of participants. For the 17.7 million ultimate transactions, the impact of the CTDL would be in the region of \$117 per trade, on an average trade size of a little over \$2 million.

For corporations, however, the situation is clearly different. The UK exports somewhere in the region of \$380 billion worth of goods and services per year. Based on the profit margins of UK companies from 1990 to 2002, we assume an average margin of 10%.³⁰ Ten per cent of \$380 billion is \$38 billion, which we take as a rough estimate of the annual profit of the UK's export sector. The impact of the CTDL on UK corporates would be somewhere in the region of \$115 million. Consequently, the impact on UK exporters would be just 0.3% of their annual profits, which is very small when set against the many other factors that influence company profitability. For example, over the past ten years, UK companies' average profitability has fluctuated by up to 10% per year. It is therefore clearly the case that when compared to the impact of changes to general business conditions, and movements in indicators such as interest rates and the sterling exchange rate, a CTDL of 0.005% will have hardly any discernable impact.

30 See Citron and Walton (2002)

Why is a CTDL at 0.005% essentially uneconomic to avoid? Would it be worthwhile for a financial institution to avoid the CTDL by leaving the CLS system?

As has been discussed, the primary reason for establishing the CLS Bank was to eliminate settlement risk – as manifested with the collapse of Herstatt Bank – from cross-border FX transactions. In this, the CLS Bank has been remarkably successful. Since its launch in 2002, the system has worked virtually flawlessly. Considering the sums involved in daily transactions, the failure of a major international bank involved in the FX market, has the potential to produce a ripple of systemic risk around the world, with unknowable consequences for both individual banks and, ultimately, national and international payment and settlement systems.

If the implementation of the CTDL did result in existing members leaving the CLS system, or provided a strong disincentive to joining, this would have serious consequences. For the CTDL to create an incentive for banks to leave the CLS system (again using the example of a levy on sterling), the costs of paying it would have to be greater than the benefits which accrue from CLS Bank membership. This is therefore a straight cost-benefit question. How do the two sides of the equation stack up when assessing a CTDL on sterling?

CLS Bank members face both fixed and variable costs as a result of their membership of the system. On the fixed cost side, these relate to the cost of developing IT systems, organisational logistics and the training of staff to enable them to function on the system. From the variable cost perspective, participation in the CLS Bank brings significant and quantifiable **efficiency gains** and reduction in **liquidity requirements/net funding costs**.

Efficiency gains

For participants in the CLS Bank, a key benefit has been the ability to increase FX volume traded, but with the same or even with fewer staff. This was illustrated in the results of a survey by the London-based Z/Yen Research group, which was based on data for 2004.³¹ The results show that average interbank FX volume increased significantly over the year, whilst average headcount fell over the same period. The survey demonstrates that participation in the CLS Bank has resulted in direct efficiency savings of 32% for participants in the system. If we assume that, on average, each FX transaction produces clear profit (in terms of the spread) of 1.5 basis points – a reasonable assumption³² – we can estimate the impact of this efficiency saving. The CLS system processes \$2 trillion of trades every day. However, CLS Bank data includes both sides of each transaction, with the result that the headline figure produced must be halved. One and a half basis point's worth of \$1 trillion is \$150 million in estimated profit per day. However, as pointed out above, operational efficiency gains within the CLS system enable participants to increase the scale of transactions by 32% with no impact upon operating costs. Consequently, participation within the CLS system offers the opportunity to increase FX profits from \$150 million to \$198 million per day, a system-wide daily profit increase of \$48 million. Taken annually, this amounts to a direct benefit to CLS Bank participants of \$12.48 billion.³³

31 See www.zyen.com for full copies of this survey

32 In 2002, for example, spreads in inter-bank wholesale markets were 0.023% for the US dollar/yen transactions and 0.021% for the US dollar/UK pound. (Spahn 2002).

33 Here and throughout we assume 260 trading days per year.

Liquidity/Net Funding cost

In domestic RTGS systems, the 'G' stands for gross rather than net. Whilst CLS Bank transactions are also settled in gross form, they are funded on a net basis. The benefits this produces are described as follows by the CLS Bank: *'By providing Settlement Members with a multilateral net position on which to base necessary daily funding rather than gross transaction-by-transaction funding, CLS reduces necessary funding by over 90%.'*³⁴

This feature of the CLS system brings real financial benefits to participating banks, which we assume fund 10% of their net funding requirements in the interbank market.³⁵ The 10% figure is the average funding gap faced by major UK banks from 2000–2003. The funding gap represents the difference between the banks' total deposits and total lending.³⁶ This shortfall must be met by external borrowing, either domestically or overseas. Clearly, a bank's activities in the domestic loan and international FX markets are very different. However, at a group level, a liquidity saving (in terms of a 90% reduction in net funding requirement for CLS Bank financing) frees up group-wide liquidity for other functions. The result is a reduction in the funding gap, and therefore a decrease in the quantity of funds that must be externally raised to support the bank's activities. The size of this reduction, it can reasonably be assumed, directly reflects the reduced liquidity requirement resulting from CLS Bank membership.

The CLS Bank's 550 members execute an average daily value of \$2 trillion through the CLS system. Gross funding would therefore necessitate the entire \$2 trillion being available for settlement (unlike the previously halved data, however, this is an accurate reflection of the real situation, since both parties to the transaction would, in the absence of any netting, be required to provide the full quantity as liquidity). By reducing the net funding requirement by 90%, however, the system only requires \$200 billion to be made available, a saving to CLS Bank participants as a whole of \$1,800 billion per day in liquidity. If we assume that, on average, 10% of this would have been financed externally, the figure 'saved' in this regard becomes \$180 billion per day. To fund this daily at an overnight LIBOR rate of 3% would cost \$5.4 billion over the course of a year (the 3% being an annualised rate and assuming 260 trading days per year). This therefore represents a saving to CLS Bank participants, which is a direct result of their participation in the system, of \$5.4 billion per year.

Comparing the quantitative benefits of CLS Bank participation, with the quantitative impact of the proposed CTDL

In a previous section, we have estimated the potential revenue that a CTDL could generate. A CTDL on sterling would generate about \$2 billion, on the euro \$4.5 billion and on the Norwegian krone about 0.17 billion. Below, we estimate the potential benefits that accrue to banks and other financial institutions from participation in the CLS system.

As is clear from Table 5, with the benefit of CLS Bank participation equating to almost \$18 billion annually, the introduction of a CTDL at a rate of 0.005% would not create any incentive for participants to leave the CLS system to avoid the levy. Indeed, in order for such an incentive to exist, the CTDL would have to be levied at a much higher level than the rate proposed.

³⁴ See *About CLS*: www.cls-group.com

³⁵ In reality, of course, banks fund their activities from diversified sources. However, the LIBOR rate offers a reasonable estimate of these sources in the aggregate.

³⁶ See Bank of England (2003) for a detailed review of the funding patterns of the UK banking sector

TABLE 5
Benefits of CLS
participation for banks

Benefit category	Annual benefit of CLS
Efficiency gains	\$12.48bn
Net funding requirement gains	\$5.4bn
Total	\$17.9bn

Furthermore, to be acceptable to central banks (with oversight responsibilities) and compatible with capital adequacy norms and anti money-laundering regulations, those wishing to leave the CLS Bank would have to set up a parallel system with similar features to those described above including close regulatory supervision. Consequently, the CTDL could also be levied through any feasible alternative system.

Could the CTDL be avoided with the use of derivative products?

Although the projection of CTDL income expressed in this report is deliberately conservative in that we do not include derivative products in the figures, it is made clear in Section 2 that implementing the levy on derivative transactions is also simple. In fact, we envisage that the CTDL would cover both traditional and the OTC FX derivative market. Thus the CTDL cannot be avoided by moving activities into the derivative market, particularly as derivative contracts are also ultimately settled in the traditional FX market.

One possible exception to this relates to ‘contracts for difference’ (CFDs) and ‘non-deliverable forwards’ (NDFs), where only the difference between the contracts (ie: the net position) is settled, as opposed to the gross value of the transactions. However, although this is the case, it is also true that financial institutions that sell CFDs and NDFs are usually unwilling to carry this exposure on their books, and therefore seek to hedge the risk these contracts entail. This hedging process can only be undertaken in those sectors of the FX market already covered by the CTDL, meaning that this also would fall within the ambit of the levy.³⁷

There are a number of other relevant factors in this regard also. First, the CLS Bank is progressively increasing its abilities to settle derivatives contracts within the system. By 2007, the CLS Bank will offer a ‘complete end-to-end’ service for the settlement of cash positions for NDF contracts, and for FX option premiums, further simplifying the CTDL collection process.

As with its other services, it is likely that the increased capacity to settle derivative contracts will result in significant cost savings within the CLS system. As we have seen, once an institution starts to participate within the CLS system, it becomes increasingly efficient to settle a high proportion of all their FX business within it. This applies to all forms of FX transactions, including derivatives.

³⁷ See *Currency Transaction Taxes; financing development and enhancing stability* by Sony Kapoor (2004) for a more detailed discussion of this.

4 Meeting needs strategically: potential uses for CTDL revenue

The three potential areas for immediate financing we have identified have been specifically chosen because their delivery will provide a significant extra value in the achievement of many development goals. Dramatic **improvements in water and sanitation**, large **investments in human resources for health to combat pandemics** and urgent **increases in financing for the UN Central Emergency Response Fund** all reach further than they might first appear in building the architecture required to combat poverty in a strategic way.

Investing in the Provision of Clean Drinking Water and Basic Sanitation

*'In a world of unprecedented wealth, almost 2 million children die each year for want of a glass of clean water and adequate sanitation. Millions of women and young girls are forced to spend hours collecting and carrying water, restricting their opportunities and their choices. And water-borne infectious diseases are holding back poverty reduction and economic growth in some of the world's poorest countries.'*³⁸

Currently, 1.1 billion people live without access to safe water and as many as 2.6 billion live in unsanitary squalor without access to something as basic as a pit toilet. This severe lack of access to the basics that we take for granted, has been directly implicated in the very high levels of morbidity and mortality seen in the poorest parts of the world. The absence of even rudimentary clean water and sanitation facilities is responsible for killing more than 1.8 million people, mostly children who die of diarrhoea every year.³⁹ More than 200 million people are infected with schistosomiasis, a water-borne debilitating disease. Other water-borne diseases such as cholera and typhoid fever are less prevalent but have much higher mortality rates.

All statistics and anecdotal evidence point to the failure of the development community to tackle the crisis in the provision of water and sanitation. Between 1990 and 2004, the number of people without access to clean water decreased only by 118 million out of a total of 1,187 million. The corresponding decrease for the number of people without access to improved sanitation was only 98 million out of a total of 2,710 million in 1990.⁴⁰ Clearly, at this rate the MDG targets of halving the number of people living without access to safe drinking water and basic sanitation (Goal 7) will not be met.

*'The combination of safe drinking water and hygienic sanitation facilities is a precondition for health and for success in the fight against poverty, hunger, child deaths and gender inequality.'*⁴¹ Failing to meet the targets and commitments on provision of proper water and sanitation facilities is undermining progress on the other MDGs especially those pertaining to health (Goal 6), education (Goal 2) and gender equality (Goal 3). Goal 4, on reducing child mortality, is unlikely to be met unless more children are drinking safe water and living in hygienic environments. Universal access

38 The 2006 Human Development Report, UNDP (2006)

39 Jose Augusto Hueb (2006) 'Trajectories of Progress Achieving the MDGs and Achieving Coverage on Water and Sanitation', WHO

40 *ibid*

41 *Meeting the MDG Drinking Water and Sanitation Target: a mid-term assessment of progress*, WHO (2004)

to education will not be realised as long as children are too sick, or too busy collecting water to attend school. 443 million school-days are lost to diarrhoeal disease alone. The many hours spent each day on average by women and school age girls collecting water from distant sources are undermining progress on gender equality.

Faced with the obvious scale and seriousness of the problems caused by lack of access to clean drinking water and basic sanitation, donor response has been baffling. For bilateral donors, resources going to the water and sanitation sector have gone down both in absolute terms from \$2.8 billion in 1995–1996 to \$2.6 billion in 2003–2004 and as a percentage of their total ODA from 8% in 1999–2000 to 6% in 2003. Total commitments to the sector have increased to \$3.9 billion in 2004 after having fallen sharply from \$3.6 billion in 1995–1996 to \$3.1 billion in 2001–2002.⁴² However, this modest increase is far from sufficient to address the scale of the challenge.

'Water and sanitation are among the most powerful preventative medicines available to governments to reduce infectious disease.' *'Every \$1 spent in the sector creates on average another \$8 in costs averted and productivity gained.'* For example, water purification explains almost half the mortality reduction in the US in the first third of the 20th Century and in the UK the expansion of sanitation contributed to a 15 year increase in life expectancy in the four decades after 1880.⁴³

We, therefore, echo the Norwegian government's own words: *'Improved water supplies, sanitary conditions and hygiene are crucial in the fight against poverty.'*⁴⁴ Our recommendation is that the Norwegian government channel the proceeds of the CTDL into spearheading the development and financing of a global action plan on water and sanitation as outlined in the UNDP Human Development Report 2006. There is an urgent need to double the current level of spending in this critical area of aid provision. A long-term predictable source of finance, such as the CTDL, that can boost such investment would generate development benefits with positive repercussions for the health, education, gender and poverty MDGs.

Investing in Human Resources for Health (HRH)

*'In global health, we are experiencing an unprecedented human resources crisis.'*⁴⁵ The WHO estimates that more than 4 million doctors, nurses, managers and other public health workers are needed to fill the gaps in the 57 countries, mostly in Asia and Africa, which face the most acute crisis.⁴⁶ The gaps in human resources and funding also mean that existing workers are overburdened, facing economic hardship, insecurity, crumbling infrastructure and high risks of infections to disease, such as HIV – all contributing to a low state of morale. *'A serious shortage of health workers is impairing provision of essential, life-saving interventions such as childhood immunisation, safe pregnancy and delivery services for mothers and access to treatment for HIV/AIDS, malaria and tuberculosis.'*⁴⁷

This HRH crisis is taking its toll. For example, *'Malawi lacks many of the staff it needs and life expectancy has declined from 48 years in 1990 to 39 years in 2000. A properly resourced health service is crucial if Malawi is to cut the number of children dying before their fifth birthday, and the number of women dying in childbirth, and to provide*

42 *Measuring Aid For Water – has the downward trend in aid for water reversed...?*

www.oecd.org/dac/stats/crs/water

43 The 2006 Human Development Report, UNDP (2006)

44 Norwegian Action Plan for Environment in Development Co-operation, MFA (2006)

45 Lincoln C Chen (2005) *Triple C's in Oslo' – consultation, consensus and call for action*

46 World Health Report 2006, WHO

47 Global Health Workers Alliance

*treatment for Malawians living with HIV.'*⁴⁸ The reforms to the health sector made under structural adjustment programs paid insufficient attention to health workers who were often seen as fiscal liabilities rather than core assets of the health systems. This severe lack of investment, barely living wage salaries, emigration by skilled staff and high HIV/AIDS related mortality amongst existing staff has meant that the problem has assumed crisis proportions. Combined with the mal-distribution of workers, inappropriate skill mixes and knowledge gaps, the HRH crisis threatens progress on all of the health related MDGs.

Compared with the bare minimum of 5 health workers per 2000 needed to hit key milestones such as 80% coverage of immunisations and skilled birth attendance, over 600 million people in Sub Saharan Africa are served by fewer than one skilled worker per 1000 population and less than 100,000 doctors in total. To reach the MDGs, Africa would need to triple the number in its workforce – more than 1 million additional workers. There are no short cuts around HRH for achieving the health MDGs and the crisis will not just fade away.⁴⁹

The resources mobilised through international initiatives such as the Global Fund have no doubt been important in focussing attention on critical issues and accelerating progress towards the MDGs. Especially for more recent initiatives such as UNITAID which focuses specifically on drugs, it is imperative to remember that without a properly trained and motivated workforce no diagnostics or treatments would work. That is why there is a need to focus on building health systems for addressing the full range of essential health needs of a population.

Many donors do not appear to have got the message yet. Despite the HRH crisis and its widespread impact, it is much easier to attract aid towards more prominent interventions such as building health facilities or supplying medicines rather than towards the more mundane business of training and hiring health workers. Donors are all too ready to build clinics but still look to the recipient government to meet staffing costs.⁵⁰ However, given the scale of the shortfall, many of the poorest recipient governments, especially those facing the most acute crisis are in no position to provide the requisite resources. The need to offer pre-service education, regular training and incentives such as extra rural sector allowances further exacerbate the resource gap.

While the life cycle of investments in health infrastructure is short, investments in human resources need to have much longer horizons. This is incompatible with the time horizon for most ODA disbursements, which rarely extend beyond five years. Even the Global Fund, which has delivery of health systems as a core mandate, only has a funding horizon of three to five years hardly enough to educate, train and recruit health workers for the long term.

The HRH crisis is crying out for a solution where donors would be able to both substantially increase resources allocated and commit them for much longer 'life-cycle' periods of 20–30 years. The substantial, long-term and predictable resources that can be mobilised by the CTDL are entirely appropriate in this setting.

48 Hilary Benn, UK International Development Secretary quoted in DfID press release dated 3 Dec 2004

49 *Working Together to Tackle the Crisis in Human Resources for Health* (2005), quoting estimates from the Joint Learning Initiative of the Global Health Trust

50 Sony Kapoor (2006) *A Think Piece: making aid more effective*, World Bank (unpublished)

Investing in an expanded Central Emergency Response Fund (CERF)

*'Not only is the world globally facing more potential disasters but increasing numbers of people are becoming vulnerable to hazards...'*⁵¹ The average annual number of disasters reported was 55% higher and the number of people affected in poor countries nearly a 100% higher in 2000–2004 than during 1995–1999.⁵² *'The urban concentration, the effects of climate change and the environmental degradation are greatly increasing vulnerability.'*⁵³

There has also been a rapid increase in the number of humanitarian emergencies some related directly to disasters and others less so. *'Again and again food crises stare Africa in the face... We're afraid that Africa's food crises are becoming accepted as "normal". WFP is feeding twice as many Africans in crisis than a decade ago.'*⁵⁴

Such disasters and emergencies undermine progress towards meeting the MDGs and the broader goal of sustainable development. A less than adequate response to tackling these emergencies rolls back what has taken years of development effort to achieve.

In light of this large increase in disasters and vulnerability which puts hundreds of millions at risk, the global community's response looks woefully inadequate. For example, the Niger crisis received only around 22% and Malawi around 30% of requested funds in the first month of the UN appeal. More widely, although UN flash appeals (for rapid onset natural disasters or sudden deteriorations in existing humanitarian crises) are put out within days, most of them receive less than 30% of requested funds in the first month.⁵⁵ In these crises, time costs lives.

Moreover, the UN estimates that in Africa alone there are more than 16 million people at risk in 'neglected emergencies and under-funded crises' where sufficient humanitarian aid does not materialise mainly due to a low media and political profile, or donor fatigue relating to protracted problems.⁵⁶ For several years recently there has been a shortfall of about \$1 billion annually in the amount needed to tackle both existing and new humanitarian crises effectively abandoning people to destitution, starvation or death once their own coping strategies and national resources have been exhausted.⁵⁷

Reacting to the urgent need for increased funding in this area, a number of countries including Norway led the effort to re-launch the UN's existing emergency response fund in the form of the CERF with a twin mandate to promote early action to meet time critical requirements and to strengthen the humanitarian response to under-funded and neglected crises. The CERF seeks to tackle disasters and other humanitarian emergencies by providing more money in a timely way.

However, even the modest funding target of \$450–\$500 million for the CERF has not been met and many commentators believe that the fund should be at least double in size just to make up for the shortfall in funding to meet current disasters and emergencies.⁵⁸ Though many countries such as Sweden and the Netherlands have pledged annual commitments, the development community's record on meeting such multiyear pledges is very poor. Thus, the CERF is likely to face some of the same problems of unpredictable and insufficient funding that afflicts current UN humanitarian

51 UN-ISDR

52 World Disasters Report 2005, IFRC, Table 1; and World Disasters Report, 2005, IFRC, Table 3, p196

53 ISDR Director Salvano Briceno quoted on BBC: http://news.bbc.co.uk/2/hi/in_depth/3666474.stm

54 James Morris, WFP Executive Director quoted in a WFP press release: www.wfp.org/English/?ModuleID=137&Key=1990

55 Jan Egland, Powerpoint presentation on 'UN Humanitarian Response: An Agenda for Reform', October 2005

56 OCHA, 13th October 2005, *Campaigns, Forgotten and Neglected Emergencies* <http://ochaonline.un.org>

57 *2005: Year of disasters*, Oxfam Briefing Paper (2005)

58 *ibid*

appeals. This will not only undermine the development community's ability to respond appropriately to emergencies but will also set back progress made on a number of MDGs including those dealing with health and education (Goal 6 and Goal 2).

To have a mechanism for the rapid disbursement of funds capable of effectively responding to the growing number of disasters and humanitarian emergencies, we recommend that the CERF should be expanded to at least \$1 billion pa and that it be funded (at least in part) by a long-term predictable source of finance such as the CTDL. Using the CTDL to fund the CERF would be in keeping with the spirit of the innovative **Solidarity Levy** – nationally collected, internationally disbursed – to pay for an agreed Global Public Good.

5 Conclusion

Today, lives are beginning to be saved by innovative financing for development. With the launch of UNITAID – primarily funded by a small aviation levy – reductions in drug prices will lead to a profound impact on the health of millions of people. However, the situation for so many of the world's population is so fragile that this progress, though important, is clearly only a modest contribution. If we are to meet the Millennium Development Goals agreed by the UN countries in the year 2000, then it is incumbent on caring nations to go much further. It is vital that UNITAID is swiftly followed by a **second development levy**.

The three potential areas for immediate financing we have identified have been specifically chosen because their delivery will provide a significant extra value in the achievement of many development goals. Dramatic **improvements in water and sanitation**, large **investments in human resources for health to combat pandemics** and urgent **increases in financing for the UN Central Emergency Response Fund** all reach further than they might first appear in building the architecture required to combat poverty in a strategic way. It is appropriate to target the largest market of the world's most powerful financial actors – the trade in money itself – to fund these weak-spots in the infrastructure of aid provision.

It is fitting that some of the massive rewards reaped by the winners of globalisation be redistributed to those who have not enjoyed its benefits and are in the greatest need. It is the contention of this report that a **small charge on currency transactions is best-placed to fulfil the role** of the next development levy to follow on from the airline duty that principally finances UNITAID.

As we hope has been comprehensively shown, **the work of leading city Think Tank, Intelligence Capital Limited, provides a blueprint of how to proceed**, demonstrating exactly how a CTDL can be plumbed into the electronic currency trading system and is uneconomic to avoid at the 0.005% rate proposed.

Moreover, the levy can be implemented unilaterally by a country (or zone, ie: the eurozone) and cannot be avoided wherever a currency is traded in the world. The key traditional objections to the proposal have, therefore, been eliminated. With the feasibility of the proposal established, it is now a question of whether there is sufficient desire and political will for a country to employ a CTDL at the earliest opportunity to join UNITAID in saving lives.

It is clear that with all the innovative development financing initiatives that have recently been implemented, one country has emerged to champion the scheme and instigate the launch of a pilot project. It is the conclusion of this report that **the time has come for a country to step forward and take the lead by piloting the CTDL** thus ensuring the second development levy becomes a reality.

Abbreviations and acronyms

ATL	Air Ticket Levy
BIS	Bank for International Settlements
CFD	Contracts for difference
CHAPS	Clearing House Automated Payment System
CLS	Continuous Linked Settlement
CTDL	Currency Transaction Development Levy
CTT	Currency Transaction Tax
DNS	Deferred Net Settlement
DvP	Delivery versus Payment
ECHO	Exchange Clearing House
FX	Foreign Exchange
IFFIm	International Finance Facility for Immunisation
LVPS	Large Value Payment Systems
MDGs	Millennium Development Goals
NDF	Non-deliverable forwards
ODA	Official Development Assistance
OTC	Over-the-Counter
PvP	Payment versus Payment
RTGS	Real Time Gross Settlement
SWIFT	Society for Worldwide Interbank Financial Telecommunications
TARGET	Trans-European Automated Real-Time Gross Express Transfer

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APPENDIX

Security transaction taxes around the world

Source: Pollin (2005)

V = VAT on trade costs

Country	Stocks	Corp Bonds	Govt Bonds	Futures	Detail
Argentina	0.6%	0.6%	0.6%	0.6%	Tax of 0.6% on all financial transactions approved by legislature March 2000
Australia	0.3%	0.15%	–	–	Reduced twice in 1990s: currently 0.15% each for buyer and seller
Austria	0.15%	0.15%	–	–	Present
Belgium	0.17%	0.07%	0.07%	–	Present
Brazil	0.3% [0.38%]	0.3% [0.38%]	0.3% [0.38%]	–	Tax on FX from 2% to 0.5% in 1999. Tax on stocks increased and bonds reduced 1999
Chile	18% V	18% V	–	–	Present
China	0.5% or 0.8%	[0.1%]	0	–	Tax on bonds eliminated 2001. Higher rate on stock exchanges applies to Shanghai
Colombia	1.5%	1.5%	1.5%	–	Introduced 2000
Denmark	[0.5%]	[0.5%]	–	–	Reduced in 1995, 1998. Abolished 1999
Ecuador	[0.1%]	[1.0%]	–	–	Tax on stocks introduced 1999, abolished 2001. Tax on bonds introduced 1999
Finland	1.6%	–	–	–	Introduced 1997, applies only to trades on HEX electronic exchange
France	0.15%	See note	–	–	Present. Sources ambiguous as to whether tax applies to bonds
Germany	[0.5%]	0.4%	0.2%	–	Removed 1991
Greece	0.6%	0.6%	–	–	Imposed 1998, doubled 1999
Guatemala	3%	3%	See note	–	Present. Sources ambiguous as to whether tax applies to government bonds
Hong Kong	0.3% + \$5 SF	[0.1%]	[0.1%]	–	Tax on stocks reduced from 0.6% in 1993. Tax on bonds eliminated 1999. \$5 stamp fee
India	0.5%	0.5%	–	–	Present
Indonesia	0.14% + 10% V*	0.03%	0.03%	–	* VAT on commissions. Introduced 1995
Ireland	1.0%	–	–	–	Present
Italy	[1.12%]	–	–	–	Stamp duties eliminated 1998
Japan	[0.1%], [0.3%]	[0.08%], [0.16%]	–	–	Removed 1999
Malaysia	0.5%	0.5%	0.015% [0.03%]	0.0005%	Present
Morocco	0.14% + 7% V	7% V	7% V	–	Present
Netherlands	[0.12%]	[0.12%]	0	–	1970–1990
Pakistan	0.15%	0.15%	–	–	Present
Peru	[0.1%], 0.08% + 18% V	[0.1%], 0.08% + 18% V	[0.1%], 0.08%	–	Financial transaction tax implemented 2003, reduced to 0.08% 2005. VAT Present
Philippines	[0.5%] + 10% V	–	–	–	VAT present
Portugal	[0.08%]	[0.04%]	[0.008%]	–	Removed 1996
Russia	0.8% [†] + 8% V	–	–	–	[†] 0.8% on secondary offerings. Present
Singapore	0.05% + 3% V	–	–	–	Reduced 1994, eliminated 1998. VAT present
South Korea	0.3% [0.45%]	0.3% [0.45%]	–	–	Reduced 1996
Sweden	[1%]	–	–	–	Removed 1991
Switzerland	0.15%	0.15%	0.15%	–	Present 0.3% on foreign securities, 1% new issues
Taiwan	0.3% [0.6%]	0.1%	–	0.05%	Reduced 1993
UK	0.5%	–	–	–	Present
US	0.0012% [0.0033%]	–	–	\$0.1	Present, reduced in 2002
Venezuela	0.5% [1%]	–	–	–	Reduced May 2000
Zimbabwe	0.45% V	–	–	–	Present

David Hillman has worked at the heart of the anti-apartheid, landmines and debt campaigns and has considerable experience of bringing together the efforts of numerous non-Governmental actors both nationally and internationally to foment change.

Currently David coordinates Stamp Out Poverty, which has been working since 2002 to open up political space for new funding initiatives to finance the Millennium Development Goals, and contributed to President Chirac's special commission on innovative finance.

As campaign coordinator of Landmine Action (1996-2000) he successfully worked for the achievement of the Ottawa Treaty and UK legislation to ban the manufacture, transfer, sale and military use of landmines. As UK arm of the International Campaign to Ban Landmines, he represented the organisation for the presentation of the Nobel Peace Prize in 1998. In 2000, he joined Drop the Debt as partner responsible for campaigns and mobilisation, playing a role in the cancellation of debt of the world's poorest countries. He studied at UCS in London and is a graduate of the University of Kent at Canterbury.

Sony Kapoor is an expert on international finance and development and has a background in investment banking and derivatives trading. He now works extensively with many organisations such as international NGOs, Think Tanks, the World Bank, United Nations and both developing and developed country governments. He is the Director of Policy and Advocacy for Stamp out Poverty, a senior advisor to Christian Aid, and sits on the board of EURODAD.

Sony played a leading role in the international effort on the recently concluded multilateral debt cancellation deal and has been actively involved in shaping the discussion on innovative sources of financing, tax justice and capital flight. Sony also works on global governance, the financial system, climate change and the environment.

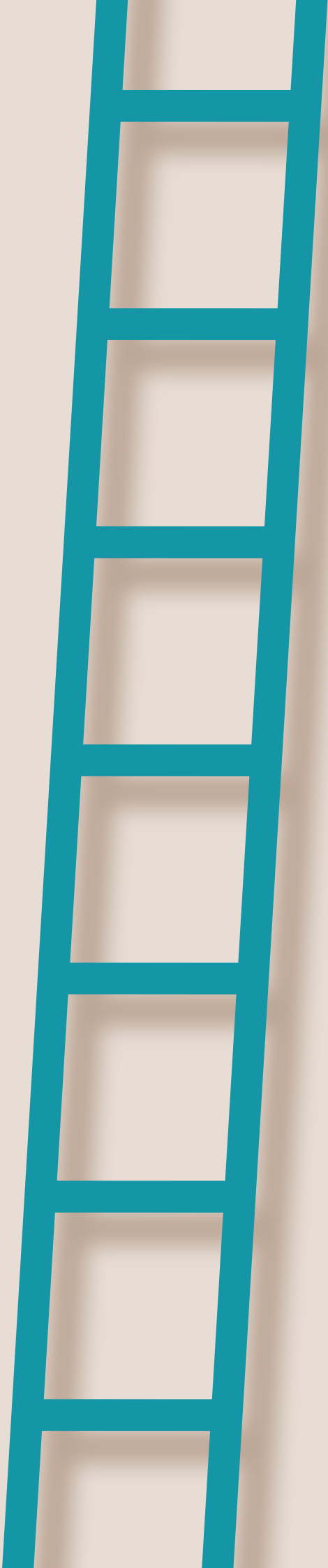
Sony holds a Chemical Engineering degree from the prestigious Indian Institute of Technology, has an MBA in finance and an MSc in International Finance from the London School of Economics.

Dr Stephen Spratt is a Senior Researcher at the new economics foundation (nef). Prior to joining nef in the summer of 2006, Stephen was a visiting lecturer on international finance and development at the University of Reading and Head of Research at Intelligence Capital Limited, a City-based research institution specialising in financial market research. He was a Senior Researcher with Global Asset Management (GAM) specialising on the global foreign exchange market. Stephen has also worked on various research projects relating to financial systems and international development at the Institute of Development Studies, University of Sussex, during which time he was also a Visiting Research Fellow with State Street Bank & Trust.

His research interests include: financial market stability, international regulatory issues, financial crises, domestic financial infrastructure, international capital flows and the governance of international financial institutions. He has published widely on all of these issues. Stephen holds a BA from the University of East Anglia, an MSc from the University of London, and a PhD from the University of Sussex.

Stamp Out Poverty is a network of more than 50 organisations including development charities such as Oxfam, trade unions such as AMICUS, faith groups such as the United Reformed Church, environmental agencies such as Friends of the Earth and Think Tanks such as the New Economics Foundation. Stamp Out Poverty works on policy, advocacy and campaign issues relating to the implementation of additional sources of finance, specifically duties or levies, to generate reliable income streams for the provision of long term sustainable development; and to combat, where linked, causes of poverty such as economic and environmental harm to developing countries.





**Taking the next step
Implementing a currency transaction
development levy**

by David Hillman, Sony Kapoor and Stephen Spratt

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