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Regulation and taxation of international capital flows as an instrument of global governance.

Second draft, December 2008[1]

by Henrik Plaschke, Aalborg University

1. Introduction - sustainable and non-sustainable globalizations

Globalization is not a well defined notion and there is widespread disagreement among observers about its definition. I shall not try to elaborate on the issue of definition. I shall rather start by noting the a process of globalization understood in a rather loose manner, i.e. as a process of intensification of global social linkages, may unfold in rather different ways depending on the articulation between a number of different political, institutional, economical, cultural etc. elements.

In order to simplify matters let me start by distinguishing between two forms of globalization which I shall denote as respectively sustainable and non-sustainable globalization. There is obviously a rather simplistic starting point which – I believe – may nevertheless serve as a heuristic starting point for further analysis.

As is well known the term sustainable may take many meanings such as ecological, budgetary or financial sustainability. In the present context I refer to sustainable globalization to denote a form of globalization which implies a reasonably balanced and fair form of globalization implying a certain *global* sharing of the economical benefits deriving from globalization and therefore also a general acceptance of globalization as an ongoing process. Sustainable globalization undoubtedly requires reasonably strong forms of international political and social organisation in order among other things to balance the effects of unregulated competition between uneven partners and to support the provision and financing of international public goods.

Similarly I may refer to a non-sustainable globalization to denote a form of globalization where the benefits deriving from globalization are highly unevenly distributed between macro-regions, countries and social classes - some win and others lose - and where ongoing processes of globalization therefore may be regarded as unjust processes to be resisted. As a result non-sustainable globalization is likely to lead to backlashes, to social conflict and to various forms of resistance which may emanate from governments, social movements, NGOs, business organisations etc.

If we depart from the two notions briefly presented above we may characterize the present form of globalization as basically non-sustainable[2]. It is accentuating international inequality, it is not allowing poor countries and social groups to be integrated in the global economy in a fair and balanced way, it is systematically creating and/or reinforcing global instability, and it is

[1] An early draft of the present paper was written in 2003 for a workshop at Aalborg University. It has, however, been updated in 2008. Sad to say the main conclusions reached in 2003 regarding the need for rather drastic reforms of the international financial system apply even more today than five years ago.

[2] See the works of e.g. Milanovic (2003) and Wade (2004) and for a somewhat different perspective Mann & Riley (2007).

weakening democratic accountability in the global political economy.

Let me underline that I am talking about *the present forms of globalization* - not about globalization per se (what ever that could be). Similarly I am not talking about the degree of globalization or about more or less globalization as if this could be measured in quantitative terms. I am talking about forms of globalization. This point may be clarified be shifting the emphasis to considering the role of global finance and capital movements in globalization.

If we approach the study of globalization from a sectoral starting point it seems rather obvious that finance occupies a key role. As is well known the last decades have witnessed drastic changes in this sector – changes which furthermore has had a huge impact not only on the rest of the economic systems but also on politics and culture in more general terms[3]. Restrictions of capital movements have been lifted in most countries of the world, international capital mobility - whether short-run or long-run - has grown much more than international trade (not to speak of international labour mobility which remains rather modest), the foreign exchange markets have grown tremendously, the political and cultural position of finance and the financial sector has changed considerably from occupying a relatively subordinate role to filling a politically and ideologically dominating role, the economic role of the stock exchange, the importance of financial innovations, and the fashionable idea of making central banks independent of government which has meant important modifications in the political position of central banks. All these factors among others testify to the increased political and economical importance of the financial sector in the international political economy.

At the same time international financial instability seems to have become an almost endemic feature of the international financial system (IFS). Not that instability is ubiquitous - it is not. But it is present all the time - somewhere and in some form. A number of so-called third world countries have experienced important forms of financial crises in recent years (including countries like Argentine, Turkey, a number of Asian countries, Russia, Mexico etc.) and since 2007/8 a serious financial crises has developed in the US – rapidly spreading into other parts of the world.

Let us, however, before entering into the terrain of international finance add a few general remarks about financial systems.

2. A note on financial systems

A financial system basically fulfils – or should fulfil - the following functions: firstly it constitutes the institutional infrastructure transforming savings into investments, secondly it supplies economic actors with means of payment, i.e. liquidity, and thirdly it provides means for preserving the purchasing power of assets over time.

In addition to these tasks the financial system also functions as an instrument evaluating in its own way the profitability of different sorts of economic activities via the financial markets. Finally the financial system may be seen as a sector of economic activity producing a certain number of outputs such as information and liquidity. As in other forms of economic activity

[3] Correspondingly the theme of financialisation has become increasingly prominent as an area of research. See e.g. Palley (2007) and Toporowski (2008).

profits may be made via this production.

Domestic as well as the international financial system may be analyzed according to the above mentioned characteristics. However, when focusing on the international financial system two specific aspects must be emphasized: *firstly* the international system is *fragmented* due to the existence of separate national currencies and systems of payment. This fragmentation manifests itself e.g. in the imperfect substitutability of assets denominated in different currencies or in the lack of a perfect international capital mobility: in empirical terms it seems reasonable to assume covered interest parity but uncovered or real interest parities do not hold (Blecker 1997).

Secondly the notion of liquidity must be linked to the notion of an international reserve currency which in reality denominates a national currency having a significant international circulation and usage[4]. Hence a country issuing a currency which is accepted both as a national and as an international means of payment occupies a particular position in the international monetary system. Conflicts between the national and the international role of the same currency may arise e.g. if the need for international liquidity is subordinated to the domestic monetary requirements of the country issuing international currency.

Thirdly the transformation of savings into investments may assume a particular character in the international financial system to the extent that it implies a transfer of savings between countries as a way of financing investment in case of insufficient domestic savings. Saving rates may differ between countries for a variety of reasons (degree of economic development, demographic structure, financial structures etc.) which may imply the need for long-run transfers of savings between countries. Empirical research initiated by Feldstein & Horioka (1980) and pursued by numerous more recent writings (e.g. Blecker 1997, Flandreau & Rivière 1999, Obstfeld & Taylor 2004) however, tends to show that national savings-investment correlations tend to be rather strong implying only limited transfer of savings between countries. Recent research, however, also indicates that national correlations are slowly weakening and hence that net international mobility of capital (i.e. transfer of savings) is increasing - possibly as a result of the financial deregulations of recent decades.

In view of the fact that financial systems fulfil different functions as indicated above it is not surprising that financial systems may be organized differently in time and space. Such differences may be assessed in different ways. In the present context the interlinkage between the three functions of the financial system mentioned above will be the point of departure.

Transforming savings into investments, creating liquidity and preserving the purchasing power of assets over time are three different sorts of tasks which may be more or less easily combined. Hence a certain balance between them should characterize a well-functioning financial system. Historically speaking, however, the self-regulation of financial systems seem to have a tendency to privilege the preservation - and sometimes rather the increase - of the purchasing power of assets over time to the potential detriment of the first two tasks. Why?

Financial markets are radically different from competitive markets as these are often depicted by

[4]In principle a reserve currency does not necessarily need to be a national currency. In the Bretton-Woods negotiations the British delegation advocated the creation of an internationally issued form of international currency to be issued by an international organization. Furthermore the euro constitutes an international currency even if it hardly occupies the role of an international reserve currency.

economic theory – at least in its textbook version: information and power relations between creditors and debtors tend to be asymmetric, transaction and enforcement costs may be significant in international financial relations, speed and mobility of funds tends to be extraordinarily high and flexible (e.g. compared to labour), the evaluation of quality may depend on prices leading to 'perverse' market reactions, self-fulfilling prophecies and cumulative dynamics may emanate from the combination of radical (i.e. non-stochastic) uncertainty and herd-like behaviour etc. (see e.g. Epstein & Gintis 1995, Orléan 1999, Stiglitz 1987). Or to put it in a slightly more simple way: after all it is no wonder that creditors *all other things equal* prefer to offer loans to seemingly good borrowers whose need for additional credits is perhaps not that urgent rather than to seemingly bad borrowers whose need for additional credits may be rather urgent. This may imply a rationing of credit access to 'bad' borrowers in need for credit and hence difficulties in compensating insufficient domestic savings by means of external finance.

As it is usually the case *all other things are not equal*. Financial systems are embedded in social structures shaping their mode of functioning (Polanyi 1957[1944]) which may provide more or less space to long-run investment finance or to the potential short-termist features of mobile finance in search not only of preserving but also of increasing the purchasing power of assets. The liberalisation of short-run capital movements in recent years, financial innovations and the explosive development of investment funds seem to have reinforced the speculative and short-run aspect of finance to the detriment of long-run finance.

3. The unbearable rigidities of the international financial system

While political and scientific analyses regarding the mode of functioning of the IFS diverge, it is, I believe, difficult to maintain that the present system works well[5]. Hardly any serious observer of international finance would claim this to be the case. Ideas of and debates about reforming the architecture of the IFS are reasonably widespread. However, in practical terms very little progress has been obtained.

What are the main problems in the current IFS? I shall not attempt to present any sort of comprehensive and exhaustive list of the main problems. It seems, however, reasonable to list some major issues and I shall concentrate on four key points in the problematic mode of functioning of the IFS.

Firstly, the IFS tends to generate and/or reinforce systematic instability.

Secondly, international short-run capital movements tend to benefit wealthy countries more than poor countries thus aggravating problems of uneven development and global inequality.

Thirdly, the liberalisation of international capital movements has reinforced *short-termism* as a basic feature of economic practice.

Fourthly, the existence of unrestricted international capital mobility raises a problem of democratic governance.

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[5] While such a point may appear to be rather self-evident in the context of the 2008 global financial crisis, it is worthwhile recalling that serious and well-founded criticism of the IFS were also formulated by informed observers in the years preceding 2008.

3.1 The history of the IFS in the last few decades may be seen as a series of mutually independent financial crises - hitting occasionally here and there. It may also, however, be seen as a history of a structurally unstable system where instability manifests itself in different ways and places at different moments of time. As a matter of fact it is rather difficult to identify prolonged periods of stability in the IFS since the start of the breakdown of the Bretton-Woods system in 1971. This is not the place to discuss the origins of the different financial crises of recent years - but it is useful to note that the mode of functioning of the IFS tends to aggravate financial crises whenever these arise and for whatever reason. There are at least two reasons for this.

Firstly, short-run capital movements tend to be pro-cyclical: if a country for some reason is suffering from economic and/or political instability this is likely to lead to out-flows of capital which again is likely to imply restrictive monetary policies in order to limit outflows of capital but with the by-effect of depressing economic activity.

Secondly, situations of international financial instability tend to be politically handled by a consortium of among others strongly organised creditors, in particular the IMF and the US Treasury, favouring creditor interests via so-called structural adjustment policies which may facilitate the re-establishment of short-run macroeconomic and monetary stability but at the expense of long-run priorities (growth, social progress, education etc.). The 2008 US financial crises is different in respect. While the treatment of credit-interests is still remarkable, it is equally striking that a financial crisis hitting the centre of global capitalism cannot – and is not – handled in the same way as a crisis in a weaker country.

The combination of economic and financial crisis, adjustment policies to save the interest of creditors, pro-cyclical economic policies and free capital flows tend to hit hard! A point which should only surprise economic observers blinded by the fancy assumptions of current macroeconomic theory. It is, however, enough to (re)read Keynes or current works combining Keynesian theory with the assumptions of imperfect markets (asymmetric information, asymmetric power relations, transactions costs, enforcement costs etc.) to get a more realistic understanding of the role of unregulated capital markets.

3.2 Short-run capital movements tend to be highly volatile. While long-run direct foreign investments tend to be relatively stable - large transnational corporations don't just move around from one day to the next as a consequence of political circumstances - the case of short-run capital movements is different. It is impossible here to summarize even the basic tendencies of short-run capital movements but a few significant points may be noted.

i) short-run capital movements tend to be concentrated to few countries, the so-called emerging economies, while other countries in particular most of poor countries tend to be net exporters of short-run capital.

ii) even in the case of the so-called emerging markets volatility is very significant. While certain periods have been marked by very significant inflows, drastic turn-abouts implying dramatic and highly concentrated outflows may subsequently be observed.

iii) while the international *gross* mobility of capital is highly significant, *net* mobility is considerably less so. Another way of making this point is to say that the international

redistribution of savings to allow for the financing of investment is relatively limited - although increasing. Domestic investment remains basically financed by domestic savings and not by an international redistribution of savings.

iv) a certain international reallocation of savings does, however, take place: the rest of the world is systematically financing the US deficits deriving from the low rate of American savings. Hence it is not surprising that the US state has been and remains an ardent supporter of free international capital movements. As long as it can 'persuade' the rest of the world to finance the excessive spending of the US economy there is little need to impose structural adjustment policies on the US economy. One may, however, quite legitimately ask whether this situation can be maintained much longer in view of the unstable nature of the US financial system, the rise of Asian capitalisms, the prospects of the euro etc.

3.3 The high volatility of short-run capital movements is related to the increased role of *short-termism* as an increasingly important principle governing the allocation of funds in the contemporary international political economy. Short-termism aims at a rapid pay-off of funds and implies a persistent search for gains deriving from marginal differences in the pay-off of different assets. It is related to speculation in the sense of this term originally given by Kaldor (1960[1939]): speculation may be defined as the purchase (or sale) of goods with a view to re-sale (or re-purchase) these same goods at a later date where their relative price is expected to be changed compared to its present price without involving any use or transformation of the goods in question. Speculation therefore implies that the buying and/or selling of goods is motivated exclusively by expectations of price changes. The spread of investment funds and institutional investors, particularly mutual funds and trust funds, has stimulated the reinforcement of short-termism.

While short-termism may appear perfectly reasonable from the perspective of the individual, it has important systemic or macro implications which must not be neglected.

i) Short-termism systematically favours instability due to herd behaviour. If the behaviour of all agents on a particular market were to converge towards a known and commonly accepted equilibrium point, speculative short-termism could be stabilizing. However, such an assumption is totally irrelevant in a world characterized by uncertainty, strategic interaction, important externalities, asymmetries in terms of information and power, etc. In such a world speculative market reactions may not only exacerbate instabilities, it may also generate instability e.g. via the development of self-fulfilling prophecies. Speculative market reactions may furthermore have irreversible effects e.g. via shifts in the distribution of income, the transfer of property rights e.g. from domestic to international capital owners, the closure of plants due to economic hardship etc.

ii) Considerations of long-term socio-economic priorities is perhaps not what we should expect from short-termism. Hence countries and investment projects in need for reliable and stable sources of long-term investment funds can hardly rely on foot-loose short-run funds. This needs not pose major problems provided that other sources of investment funds are available. The problem, however, is that the spreading of short-run investor norms tend to exert contagious effects on other sources of finance implying that the short-run is increasingly becoming the norm required by investors. The incentive structures (the possibility of gains) built into the financial markets, particularly the mutual funds, tend to generalize itself unless it is

compensated by other forces. Pensions funds could (and - perhaps - should!) favour a more long-term based investment strategies.

iii) All economists are familiar with the idea that there is no such thing as a free lunch. However, when listening to the neo-liberal economic discourse one sometimes may get the impression that this beautiful piece of imagination - the free lunch - has finally been located in real life! It is obviously possible to identify cases where the systemic search for short-run gains has produced clear-cut benefits - if not for everybody then at least for some... The drawbacks of short-termism should, however, not be neglected. Job uncertainty and deteriorating workings conditions may be the price of the systematic pursuit of short-run financial gains: all markets cannot be equally flexible all the time. Hence investor claims for high short-run profitability in some sense requires adaptation and/or flexibility elsewhere, e.g. on the labour market. Similarly the unrestrained search for short-run gains tend to weaken the bonds of social solidarity necessary to maintain and finance social cohesiveness unless it is compensated by strong social institutions and/or public intervention.

3.4 Last, but not least, the existence of unrestricted international capital mobility raises serious problem of democratic governance of the international political economy. Governance by democratic vote ('one man = one vote') is radically different from governance by economic force ('one mint = one vote'), and democratic rule is among other things strongly rooted in the equal rights of all human beings - whether rich or poor. Consequently democracy has provided a strong instrument for modifying the balance of power emanating from the uneven distribution of economic power.

In the international political economy a high degree of capital mobility implies the option of *exit* rather than *voice* (Hirschman 1970) for capital-owners. In political terms a high degree of capital mobility without strong international political institutions with democratic accountability therefore implies a relative strengthening of governance by economic force rather than by democratic vote.

To some observers this may be seen is a virtue rather than a vice. If markets and/or capital-holders are seen as rational and impartial observers of economic reality, it could be argued that economic decision making should be left to impartial and anonymous market forces rather than to elected politicians with their own partial interests at stake. This argument, however, presupposes that market forces - or to be more exact: capital-owners and investors - are neutral and impartial observers without interest in influencing the distribution of economic and political resources. It remains to be demonstrated why this should be the case.

A democratic steering of the economy starts from the premise that contradictory interests with regard to basic economic interests and priorities do exist. Such differences have to be managed and a first premise for such a management should be not to conceal the reality of diverging interests. Subsequently the diversity of interests may be managed via negotiations, subsequent compromises and redistribution of income both to compensate economically weak groups and to finance the provision of common or public goods. This has been the foundation of the European welfare states after World War II, and hence it has also been the foundation for one of the longest and most stable period of economic growth ever to exist.

Could we imagine such a model to be developed not only for single countries but for a global

context? This among other things raises the issue of international taxation as a basis both for redistribution of income and for the financing of global public goods. Nobody likes to pay taxes. But the payment of taxes may also be seen as a necessary precondition for civilized life since it allows for solidarity and the maintenance of interests common to mankind. While necessary it is obviously not a sufficient precondition. I shall return to the issue of taxation below.

4. Reforming the international financial architecture?

As noted above there is an increasingly widespread consensus among observers that the present IFS is not functioning particularly well. For a number of years this issue has been extensively discussed in international fora under the heading of reforming the international financial architecture. The recurrent financial crises in Latin America, Asia and now in the US have given this discussion an increasingly urgent character. The present financial crisis in the USA indeed reinforces the sentiment of urgency.

Yet, it may also be noted that very little progress has been achieved so far and the ongoing discussions on reforming the IFS within the Western governments and the international financial institutions such as the IMF, BIS etc. are far too unambitious.

Current discussions on reforming the IFS tend to be centred on issues like more transparency on the financial markets (in particular among debtor countries), increased private sector sharing of the costs of financial crises, and increased capital requirements for certain forms of lending. These issues are certainly not to be dismissed. But they are insufficient and in certain respects somewhat problematic.

4.1 Let me start with the issue of transparency. Increased transparency could certainly be a good thing and it sounds appealing. However, two important points need to be noted:

Firstly it is striking that the demand for increased transparency is mainly directed towards debtors and not towards creditors, the international financial institutions such as the IMF or the large international investment funds. The practices of these latter are not very transparent. Why this highly selective approach to transparency? Perhaps because major economic and political interests are at stake? If this is the case we must realize that the combination of transparency for debtors and non-transparency for creditors, Treasuries, the IMF and the investment funds simply equals a political strengthening for the latter with respect to the former! Perhaps this is a good idea (although I doubt it), but let us then be clear and outspoken about what is at stake rather than try to conceal the real issues behind a technical language that very few people will grasp. Or perhaps, it is not such a good idea. In that case let us rather advocate a more symmetric form of transparency not only implying transparency among the debtors!

Secondly it is rather unlikely that increased transparency will solve the underlying problems of the IFS. Behind the emphasis for more transparency we find a conception telling us that if the same information were available to all relevant actors (including both policy makers and market participants) uncertainty would be strongly reduced and financial markets would be much more stable. This conception, however, assumes that all actors will *assess* this information in the same way. Such an assumption is hard to justify. There are many ways of e.g. ranking the importance of different economic indicators which again may lead to differing assessments of the same sort of economic indicators and consequently also to different ways of coping with the intrinsic

uncertainty characterizing the financial markets. Herd behaviour does not only derive from differences in available information but also from differences in *assessing* available information in a state of uncertainty.

4.2 Other issues debated in current discussions on reforming the IFS include e.g. increased private sector sharing of the costs of financial crises and increased capital requirements for certain forms of lending. Regarding the idea of increased private sector sharing it seems increasingly likely that such a practice will be strengthened by the current financial crisis – at least in some countries. However, it also seems as if important creditors will be well compensated for their sharing of costs… Otherwise we may simply note that such a scheme - if it were to function - could have positive and stabilizing effects in terms of a more prudential behaviour from the side of creditors. Whether it would improve the situation for debtors is more questionable.

The idea of increasing capital requirements for certain kinds of loans, including inter-bank loans, is less controversial in political terms and a certain progress has also been made in this respect. It is, however, also a much more modest step which is likely to have a positive but not very substantial impact on the issues at stake in the IFS.

More radical steps are needed.

5. Premises for a more radical reform of the IFS?

A reform of the IFS should indeed include much more radical steps than what has been briefly discussed above. However, in reality they are not that radical - to a large extent they simply imply a return to the spirit of Keynes – and Keynes was not particularly radical. A return to the spirit characterizing the compromises of *embedded liberalism* (Ruggie 1982) established after the end of World War II.

At least four aims should guide such a reform:

i) Greater stability on the financial markets;

ii) Better allocation of capital flows and savings implying better growth possibilities for 3rd world countries plus the creation of means for financing international public goods;

iii) Limitations on the present form of speculation based short-termism in favour of long-term aims of sustainable economic development;

iv) Reinforced democratic governance and accountability in the global economy connected to an empowerment of democratically accountable international institutions vis-à-vis financial interests;

Or to put it in different terms: the last decades have witnessed a shift of power favouring the financial sector and global capital interests. The results are hardly encouraging. The trend needs to be reversed in order for finance to become the servant rather than the master of social, economic and political development.

Reforming the IFS along the lines mentioned above obviously relate more to power interests and politics than to technicalities - even if the latter aspect cannot be ignored. In this sense the question of who benefits and who loses from deregulated finance and free capital movements is important.

An extended discussion of this question is not possible in the present context. Let me just emphasize that important interests are at stake - both at the state level (the USA in particular), within states (central banks in particular) and among private interest groups particularly related to the financial sector. If we turn our attention to other private economic actors, including 'normal' holders of bank deposits trying to make the best out of their savings and trying to make a living from working rather than from engaging in speculative activities, matters become more complicated. It is, however, my basic conviction that most 'normal' savers would most likely be better off by a reformed IFS than by the present finance-driven system with all its drawbacks. The great cultural and political task facing us as researchers and citizens, however, is to demonstrate this so as to turn it into public knowledge.

6. Steps towards a more radical reform of the IFS

A more radical reform of the IFS along the principles discussed about should at least include the following elements:

> i) A reform of the international institutions – whether formal (e.g. the IMF) or informal (G2/G8/G20) and their linkages to regional bodies (including regional development banks);
>
> ii) The development of currency blocks – including regional monetary unions as an alternative to dollarization;
>
> iii) The introduction of a tax on short-run international capital movements and/or financial transactions in general;
>
> iv) Other sorts of international taxation;
>
> v) Better possibilities of capital controls;
>
> vi) The abolition of off-shore tax havens allowing tax evasion for capital-holders.

The present text will not deal with all of these aspects. Rather it will be attempted to discuss whether and to which extent a taxation of currency transactions may contribute to the realisation of such a reform. The focus on the present text is thus on iii). Some of the other mentioned aspects will be touched upon when pertinent for the discussion of taxation[6].

6.1 In view of the relatively high degree of international financial and monetary integration it is

[6] The role of the IMF will not be discussed in the present context – even if could play a potentially important role related to a possible form of international tax collection. A discussion of the potential and/or limits of the IMF in this connection, however, is not necessary for my discussion. Furthermore the present does not discuss the questions of capital controls and off-share tax-havens although both could be linked to the discussion of taxation.

hard to escape the conclusion that for many countries of the world the real choice in terms of money and finance is between some sort of currency block and/or monetary union and dependence on the dollar and/or dollarization of the economy as it is increasingly seen in Latin America. The perspective of national monetary autonomy appears as rather unrealistic.

The experience of the European Monetary Union (EMU) and the common European currency represents an attempt towards a collective management of *joint* monetary autonomy in an increasingly globalized world economy. There are good reasons to criticise the current form of the EMU and similarly it is unlikely that the monetary union will be maintained unaltered in its present incarnation. The badly conceived Stability (and Growth?) Pact has been reformed, but the economic policy regime of the EU is still not supportive of growth and employment[7]. The institutional architecture of the EMU is characterized by important democratic deficiencies related to the status of the European Central Bank. The basic priorities of the EMU are biased towards a unilateral emphasis on price stability.

In spite of these criticisms - and others could be added to the list - the EMU does represent an attempt to cope with Europe's monetary dependence of the dollar. This attempt remains too timid and defensive and European decision makers seem to be far from thinking in terms of the monetary and political potential that could be derived from a common currency. A potential that could be used for asserting greater European *political* autonomy in the global system and hence also a greater autonomy regarding the social choices to be made regarding the future social structures of the European continent. Taking into account the present (?) form of American unilateralism as well as the economic and financial dependence of many poor countries on Western economic interests it is hardly surprising that the European common currency also has attracted attention outside of Europe. We may also add – and this point brings us directly to the next point of the discussion – that the existence of monetary unions and/or currency blocks may favour the possible imposition of a currency transaction tax for the very simple reason that the unilateral imposition of a currency tax may be easier for a larger group of countries as perhaps unified by a common currency than for individual states which are vulnerable to instabilities in the international economy.

6.2 The idea of a currency transactions tax has in recent times been forwarded by the American economist James Tobin who launched it in 1972. In recent years the idea has gained increased interest following the international financial and currency crises of South East Asian and other countries. Furthermore the idea has been taken up by a number of NGO-movements advocating a tax on speculative capital movements and a number of reports from governments and international organisations have also assessed the potential of some sort of a currency transactions tax in positive terms. Following the initial idea of James Tobin such a tax has often been referred to as a Tobin tax, but following a number of more recent propositions it presently seems more appropriate to go beyond this terminology and to refer to a currency transaction tax (CCT) or to the broader notion of a financial transactions tax (FTT) including all sorts of financial transactions and not only transactions involving the foreign exchange markets.

While these *terms* are quite recent it may be added that currency transaction taxes have been attempted previously. Thus according to Flandreau & Rivière (1999) the three major financial

[7] As noted by the Commission "while not fully eradicated, pro-cyclical fiscal policies, have also become less common" (Commission 2008, p. 4).

centres of the world economy (England, France and Germany) practised a kind of 'Tobin Tax' (obviously named differently) in the period up to 1914. Even if we have rather little knowledge of this early 'Tobin Tax' it is a least worth noting that it co-existed with a relatively high degree of net international capital mobility as measured in terms of savings-investment balances. Causal analysis should be avoided on such a fragile basis, but it seems possible to conclude that this version of the 'Tobin Tax' at least did not preclude long-run capital flows and access to external savings.

The basic idea of the Tobin Tax is quite simple: since currency markets are destabilized by speculative capital flows emanating from marginal differences in the yield of different assets, in particular currencies, or from anticipated changes in currency values, a very modest taxation (e.g. 0,1 %) of all transactions involving more than one currency could exercise a stabilising effect on currency markets by cutting speculative transactions dependent on equally small differences in (expected) yield. Tobin basically proposed this taxation in order to stabilize currency markets. Subsequent analyses, however, have also pointed to potentially positive effects in terms of revenue generation (e.g. ul Haq et al. 1996). There is a trade-off between stabilization and generation of revenue: the more you stabilize the less revenue and vice versa. However, stabilization and generation of revenue may be combined in many different ways even if total stabilization will exclude income generation.

The last few years have witnessed a number of new contributions to the debate on currency and financial transaction taxes (e.g. European Parliament 2002, ul Haq et al. 1996, Jégourel 2002, Jetin & Denys 2005, Landau 2003, Patomäki 2001, Schulmeister et al 2008, Spahn 2002). Let me, however, try to summarize some main points in the discussion:

i) The feasibility of a CTT. When assessing the feasibility of the CTT it is necessary to distinguish between the *technical*, the *legal* and the *political* feasibility of the Tax. The technical and legal problems involved in a CCT can be solved, if we are to believe the conclusions of a very thorough recent study (Jetin & Denys 2005)[8]. The real problem is that of the political feasibility.

The political feasibility of a CTT involves diverging political interests. The basic question to discuss, however, seems to be whether the imposition of a CCT requires the participation of all countries of the world or whether it is possible for a limited number of countries to introduce the tax unilaterally. In this respect the conclusion would be that it is obviously an advantage if many or all countries participate in a CTT, but that it is possible for a smaller group of countries (e.g. the EU countries) to introduce a unilateral CTT. Problems of tax evasion can be countered in various ways (imposing requirements on banks operating on a given territory, mandatory deposits etc.)[9]. In addition to this sort of political problem it is also rather probably that a CTT may encounter political resistance emanating from ideology rather than from feasibility[10]. We

[8] And following the recent work by Schulmeister et al 2008 we may add that the imposition of a FTT rather than a CCT in principle would be less complicated because a FTT does not require any sort of discrimination between different markets.

[9] In this context we may also refer to the demonstration made by Schulmeister et al (2008, pp. 24-26) that the British "stamp duty" on stock transactions is rather successful. A comparatively high tax rate on stock transactions is compatible with the attractiveness of the London stock exchange. The authors note in this context that "the importance of the tax design cannot be overrated" (p. 27). This point may also apply in other contexts.

[10] The opposition to a CTT voiced by the European Central Bank (2004) is revealing in this regard. See also Jetin & Denys (2005, pp. 184-228) and Wahl (2005).

may also add to the question of political feasibility that the degree of political acceptance of or resistance to ideas of regulating global financial markets – via a CTT or otherwise – may to a certain extent reflect the general economical and ideological "mood" of our time and surroundings.

By making this claim I do not wish to rely on any sort of crude materialism ("financial instability leads to a retreat of the forces of global capitalism") but on the other hand it is for instance rather unlikely that the present financial crisis and/or break-down will have no effect whatsoever on the balancing of power between forces advocating and forces resisting a reinforced regulation of global finance along the lines advocated here[11].

ii) Originally the Tobin Tax was conceived as an instrument for limiting currency crises by making international capital movements less profitable. One may also say that the purpose of the tax was to curb the power of capital owners to exercise exit power on national governments by capital flight. Subsequently a number of observers have pointed out that a CTT may be effective only in countering rather small fluctuations of currency markets, while it is rather useless in case of major speculative attacks because of its modest size. This criticism is undoubtedly correct regarding the traditional Tobin Tax. However, a consistent way of coping with this issue has been proposed in the report commanded by the German Ministry for Economic Cooperation and Development (Spahn 2002) who proposed a 'two-tier" tax where the 'normal' (very low) Tobin Tax is combined with a significantly higher tax rate which is automatically activated in case of excessive exchange rate volatility[12].

iii) stabilization versus generation of revenue. As mentioned previously there is a trade off between the generation of revenue to result from a tax and its impact on flows: the higher the impact on flows, the lower the generated income. As mentioned previously the original Tobin Tax proposal was meant to stabilize markets and not to generate revenue. However, subsequently the possibility of generating revenue was raised, and furthermore debates on how to counterbalance the uneven effects of globalisation and on the need for sources for the financing of global public goods[13] lead to a search for adequate sources of funding for these new needs. A number of attempts to quantify the effects of a CTT have been made[14]. While these should obviously be treated as highly tentative, it is nevertheless noteworthy that all the quoted studies conclude that a CTT (or a financial transaction tax) does have a significant economic potential in terms of generated revenue.

iv) how to use the revenue from taxation. The CTT has sometimes been criticised for a certain vagueness regarding the possible use of the revenue generated from a CTT. In view of the fact that reforms policies are often criticised for being too costly, it is in a certain sense rather

[11] Or to put it in different terms: we may say that a period of global financial instability and crisis may open a window of opportunities for social and political forces aiming at curbing the power of capital owners in the global system. Whether this window of opportunity actually will be used and exploited by political forces is another question.

[12] The two-tier scheme proposed by Spahn (2002) is further discussed and developed by Jetin & Deny (2005, especially pp. 46-60).

[13] Possibly linked to the so-called Millennium Development Goals.

[14] E.g. by Jetin & Denys (2005, pp. 130-151) and by Schulmeister et al. (2008). Jetin & Denys also provide a useful summary of previous estimates of the potentials of a CTT while the study by Schulmeister et al focus on the potentials of a general financial transaction tax not only related to currency transactions.

refreshing – not to say amusing - to encounter this sort of criticism: what are we going to do with the money! Yet, the question of how to use the revenue from taxation is a very real issue meriting debate. A first issue concerns the distribution of revenue between national and international (or regional) bodies. A second issue concerns the question of whether revenue should be used (earmarked) for particular purposes or whether it should provide general income for recipients (whoever they are: national, regional or international).

The question of how to distribute tax incomes between recipients recalls the classical link between taxation and representation. Or in other words: taxation requires legitimacy in order to be justifiable. In principle states enjoy a certain legitimacy – a fact which is not necessarily the case of international bodies. It could on the other hand be problematic simply to allocate revenue to states since this would run counter to the need for the financing of global projects. Could these different considerations then be combined? Two ways of doing it would be on the one hand to earmark funds for purposes enjoying a reasonably high popular legitimacy and/or acceptance: the Millennium Goals could be an example; more specific cases could also be thought of, e.g. linked to the provision of cheap medicine to developing countries as in UnitAid which is financed by taxation on air tickets and which therefore can be considered as a form of taxation of globalisation. On the other hand a certain splitting of revenue between national and international recipient could also be developed. This would provide an incentive to national governments for supporting such schemes. Other sorts of incentives could also be developed: it would for instance be possible to link the receiving of funds from an international tax collection body to the fulfilment of different criteria such as the living up to various standards of e.g. human and/or social development.

v) The discussion above has focused on the CTT. However as hinted at above the CTT may be further extended via a general financial transactions tax (FTT) as analyzed by Schulmeister et al. (2008). While there are differences between the CTT and the FTT in various respects[15] it is equally clear that there are important parallels related in particular to the fact that both tax forms involve a taxation of financial transactions – and hence also an attempt to limit the effects of financialisation and financial logics on economic and social logics. In this regard the CTT and the FTT are parallel and may be mutually reinforcing. Similarly both the CTT and the FTT may possibly be combined with other sorts of measures meant to curb financial instability if appropriate[16].

vi) If we briefly return to the question of mobilising financial resources for the funding of various sorts of public goods it may also be added that the discussion of the CTT as outlined above is only one aspect of a larger discussion – academic and political – about global taxes and about the governance of globalisation. This discussion will not be discussed any further here but it worthwhile mentioning that different sorts of international taxes are presently being discussed (environmental taxes, emission taxes, taxation of off shore banking centres etc.)[17]. Furthermore the last few years has seen the launching of the first effectively functioning form of a tax on globalisation: an air ticket tax financing the supply of cheap medicine for developing countries via UnitAid[18].

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[15] In particular because the FTT applies to all sorts of financial transactions whether related to currency markets or to markets and whether involving cross-border transactions or all sorts of financial transactions.
[16] E.g. limits on capital inflows and capital controls.
[17] For a brief survey see Wahl (2006).
[18] To my knowledge no research has yet been carried out on UnitAid and its results (web site:

7. Concluding remarks

For the last couple of decades the global political economy and a vast number of national economies have been experimenting with various sorts of neo-liberal policy strategies. Free capital movements, the predominance of finance and the logics of financialisation have set the framework for global economic developments. There has been no shortage of warnings against these developments of a finance based globalisation – and more generally speaking against ungoverned globalisation[19] – but since the outbreak of an open financial crisis in the late summer and autumn of 2008, the seriousness of the situation has been acknowledged by a great number of observers, including writers previously paying tribute to the virtues of neo-liberal globalisation[20]. Unregulated financial globalisation is even seen as a threat to globalisation in more general terms and there is a growing anxiety that unless better and more effective forms of governance of globalisation can be put in place – urgently – the crisis may imply a major backlash for the global economy.

The issue of global taxes discussed in the preceding pages is linked to this set of issues. It has been argued that there is a need for a comprehensive reform of the international financial system and various elements in such a reform have been briefly identified. Some of these elements have been discussed somewhat more and it is perhaps useful at this moment of time to insist on the need for the development of international taxes as one crucial issue out of several for the present and future forms of globalisation – and why not? – global society. Why? Global taxation is no panacea but it does provide potential solutions to two rather crucial issues in the current global impasse: *firstly* it is a tool for curbing and limiting the economic impact and political power of global capital holders and financial actors. It may thus constitute a step towards arresting the financialisation of national and global economic systems so predominant during the last decades, and it may also imply a step towards the reinforcement of voting power ('one man = one vote') to the detriment of capital power ('one mint = one vote'). *Secondly* it provides a potential instrument for the generation of revenue urgently needed for the financing of global public goods and/or global redistribution towards parts of the world not or only marginally benefitting from the gains of economic globalisation.

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http://www.unitaid.eu/)

[19] The recent book by Artus & Virard (2008) is an excellent recent example.

[20] The case of Martin Wolf in the *Financial Times* is an excellent example as one may note it by comparing his writings on new capitalism (e.g. June 19, 2007) with his more recent columns. The contrast is striking.

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