By Pradeep S Mehta and Anurag Srivastava

James Tobin’s suggestion of ‘throwing sands in the wheels of international finance’ by taxing currency trading has become a vociferously advocated initiative in the post-crisis discourse on reformative regulation. The call is worthy to take a close look, as it emphasises the need for this tax in the context of ‘elusive’ capital while fiscal deficits are compounding human development deficits. With high debts with major governments, we believe that leveraging liquidity is desirable and hopefully, the political will is not ossified.

The G20 committed a stimulus package equal to 1.1 percent of the world’s GDP to resolve the global economic crisis at the London summit in April 2009. Boosting IMF resources by $1.1 trillion in line with this aim was also declared. A rescue package of a trillion dollars has been committed by the European Finance Ministers in May 2010 to deal with the current European crisis.

The successive meetings of the G20 find the group waning on the promise and purpose of stabilizing the global economy - one reason being the elusive ‘trillion’ and the successive ones that must follow to walk the talk.

The spending needs by the government seem to be in a fierce competition with the need to save. At the most recent G20 summit at Toronto, nations jointly decided to reduce deficits as a priority and gradually pull back their stimulus spending. This stance may translate to a conscious economic contraction. Never before in global economic policymaking has the need for saving and spending been felt as acutely and simultaneously.

The costs of solutions to American and European economic problems stand calculated with the world’s mightiest economies desperately looking for fresh funding sources. Such collective effort has never been deployed to address financing key human development challenges of literacy, health, nutrition and employability in the developing world - issues which are as important, if not more as the concern for social security in Italy and Greece. The G20 governments must find capital for growth as well as human development to have lasting sanctity and public acceptability.

Contrary to popular perception, the world has not been left dry without liquidity, nor is global capital concentrated in an emerging Asia alone—much as the world believes that all dollars rest in Chinese vaults. Much capital travels across the globe translating into liquidity many times over. Political will is needed to recognise drivers of global capital and liquidity and therein leverage critical finance for human development and growth. A look at trade across currency and forex markets is warranted—where untouched by the recession, money yet moves full steam globally.

Rescue policies do not gravely affect forex markets unlike the stock and bond markets. Daily currency trade is yet about $3 trillion - closer to the last official figure provided by the BIS (2007) of an average daily trade of $3.2 trillion.

In this context, the Tobin Tax appears very desirable which concerns taxing spot currency transactions at a nominal (0.5%) rate. The key objectives as proposed were to facilitate monetary policy autonomy to national governments in face of destabilising capital movements and to raise critical capital for international development goals.

As per our calculation, even at 0.25% - half of the suggested 0.5 per cent, the tax can annually raise $3 trillion globally. This is more than $1.1 trillion ‘committed’ stimulus by the G20, the $1.0 trillion ‘needed’ by Europe currently and the total of ODA, all put together.

Compelling reasons for such taxation, apart from current financing needs are presented, which will go a long way in absorbing future shocks and preventing fiscal bankruptcies. A study by Harvard economists Frankel and Saravelos looking for the most prevalent and explanatory factors preceding a series of crises in the ‘90s found exchange rate fluctuations as the key one. Generally, with an increase in capital moving in a country, there is currency appreciation making exports expensive and creating an inflationary spiral. When the money flows out, currency depreciates, creating balance of payments problem. Even in the absence of major fluctuations (read crisis) such as in Argentina (2001) or Thailand (1997), a general and undesirable nervousness over moderate disturbances persists in developing countries.

Economic theory postulated that exchange rate changes will lead to reallocation of productive resources and the balance of payments will automatically stabilise. Exactly the opposite has happened with capital moving overnight, affecting currency values and creating volatility with speculative attacks. Needless to say most developing country governments have not been able to maintain autonomy in this sphere. They can, as per the famous trilemma, choose only two of the three from among: fixed exchange rates, free capital movement and an independent monetary policy. The current financial trade regime greatly limits governments’ authority in regulating capital or controlling their exchange rates. Tobin Tax can play a key role in dealing with volatility and speculative attacks.

Written off for different reasons, discussions on the tax have an interesting political precedent in the US. Introduced in the second session of the 104th congress, a bill titled Prohibition on United Nations Taxation Act of 1996 successfully prevented UN led discussions on the Tobin Tax. There is no other example in history where the ideas of an economist have been prohibited from discussion by legislation even as dissent has been a norm across key American academic centres.

Even with the phase of unipolar world order having passed, multilateral political acceptance is a challenge together with other minor ones for bringing in a taxation regime as this. A cooperative G20 stance can help ease the problem emanating from a selective and/or unilateral imposition of the tax and also address the challenges of accounting and implementation. The latter are smaller hindrances given that final clearances happen only in key markets and the trade is now internet based and can be followed with ease.

There is no reason why the G20 countries including India which has close to $30 billion of daily foreign exchange turnover should not come together and create a movement for this possibility.

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However given the widespread criticism of explicit partiality to developed nations’ role and participation in the IMF, a UN agency or perhaps a fresh UN commission is the best institution to initiate the idea.

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