METHODIST CONFERENCE 2001 REPORTS

The Tobin Tax

Background

The 2000 Conference accepted a reply to Memorials 85-87, on the Tobin Tax, which concluded with these words:

The Conference

a. expresses its support for the principle of a tax on currency speculation and for the use of the resulting revenue for international development as proposed by the Nobel prize winning economist James Tobin;

b. calls on Her Majesty's Government to work through the G8 group and the Organisation for Economic Co-operation and Development (OECD) for the study and implementation of these proposals;

c. refers the question of how the Methodist Church may further support these proposals to the Connexional Team, for report to the Conference in 2001.

A letter was sent to the Chancellor of the Exchequer in August on behalf of the Methodist Church to fulfil the remit in b). The Economic Secretary to the Treasury, Melanie Johnson, replied. She stressed the initiatives the Government has taken to promote more stable international capital flows in conjunction with G7 partners. She explained that the government had considered a Tobin Tax as one possible element of a wider package of international reforms but had concluded it might actually increase volatility as well as being almost impossible to enforce.

Despite these assertions from the Treasury, it is clearly important that the Methodist Church is equipped with a response to part c) above and given some independent material on the Tobin Tax. Hence the preparation of this paper. It was debated within the Connexional Team. It has also benefited from comments made on earlier drafts by a number of people known to have an interest in aspects of this subject. It is now offered to assist wider discussion within the Church.

Campaigning literature on the Tobin Tax has been available from War on Want and elsewhere since before the 2000 Conference. Given this and the complexity of the markets in which the tax would operate, the Connexional Team felt their most helpful contribution to the 2001 Conference would be to provide an explanation of the currency markets and an analysis of the issues that the Tobin proposal raises. It is hoped this will give greater confidence to Methodists in addressing the underlying issues and help them decide where best to focus their campaigning energies.

Summary

After noting the Church context for the discussion (paragraphs 6-10), the paper expands on the background to the Tobin proposals, not least because this will be unfamiliar territory to many Methodists (paragraphs 11-22). It describes the claims made for the Tobin Tax (paragraphs 23-32) and considers some objections to those arguments (paragraphs 33-52). It points to some of the more fundamental issues that might be seen behind the Tobin Tax idea (paragraphs 53-57). Finally it outlines a possible response for the 2001 Conference (paragraphs 58-61).

The Church Context

Methodists have always believed that Christian Faith must lead to active concern for the world around them and appropriate social action for the benefit of all the human family. In this they draw on an ancient tradition. The Old Testament prophets were willing to challenge impossibly powerful kings with their own selfishness and wilful blindness, especially when it affected those with little influence of their own. They challenged the merchants when their scales were distorted in their own favour. While the prophets ranged widely, two features of their work are particularly relevant here.

Firstly, they were not afraid to question economic relationships as well as personal behaviours. The first friends of Jesus would have been confident, from hearing what are now the first five books of the Bible, especially Leviticus, that their God was interested in economics. The prophets did their best to express these principles in the specific economic setting of their time.

Secondly, the prophets had no degrees in economics and were no doubt scorned by the sophisticated royal advisers. Nonetheless they believed it their duty to speak out about manifold injustice even if sometimes they could not offer precise analytical route maps for constructing an alternative society.

Fortified by such precedents, the Methodist Church has aligned itself in recent years with a number of campaigns reflecting an underlying unease about trends in the global economy. The world economy is immensely complex and far harder to analyse than the agricultural communities of ancient Israel. Many Christians are aware they have only a partial understanding but still want opportunities to express their concerns for groups who regularly seem to be the losers.

The 2000 Conference saw the current revival of interest in the Tobin Tax idea as a vehicle for expressing these anxieties. It was also seen as potentially a way of organising practical help. This paper attempts to help the Methodist people assess how far these particular proposals are the best means to this shared end.

The Concept

In 1978 a prominent American economist, James Tobin, suggested in a well-publicised Washington lecture a tax on foreign currency deals (A Proposal for International Monetary Reform Eastern Economic Journal 1978 Volume 4 pp153-9). It was an idea he had first put forward in 1972 and he repeated it in 1978 "regretfully". He felt the international financial system needed greater integration and co-ordination but if that were not forthcoming his tax idea was a second best and partial palliative. His name has been attached to a revived international campaign for such a tax over the last couple of years.

A Tobin Tax would be a levy on foreign exchange transactions, the amount of the levy being proportional to the size of the transaction. The usual proposal is for a rate of 0.25%, ie a levy of £25,000 on a transaction of £10mn.

As at the Conference, the proposal for the tax is often linked with the proposal for the proceeds to be hypothecated for international development: ie not be added to general tax revenues but kept separate to be devoted exclusively to this particular category of government expenditure. Tobin suggested proceeds might be handed over to the World Bank.

The Foreign Exchange Markets

The following paragraphs offer a simplified description of highly sophisticated markets. Some understanding is essential however if the impact of Tobin is to be analysed adequately.

International trade takes place in a variety of currencies. A Briton wishing to buy products priced in US dollars needs to obtain some dollars. On his behalf his bank will buy dollars at the current exchange rate. The bank will make its money by charging an identified price for providing this service or by adding a margin to its exchange rate. Few doubt that he and his bank have behaved legitimately (assuming the purchase itself is not morally doubtful).

If the same Briton were an investor who wanted to spread his risk by investing in the USA, he might similarly ask his bank to buy him dollars. With the dollars he obtained he might then invest in American companies or property. Some people might object to his wealth or to his disinclination to invest it in Britain, but again few would question the propriety of the bank's action in accordance with his instructions or his right to spread his risk.

While some banks only buy and sell currencies directly or indirectly at the request of customers, many undertake "own account" deals where the motive is to make money purely out of the trading activity itself. Exchange rates are constantly fluctuating due to changing fundamentals in the currencies' home economies and to changing subjective views on those fundamentals by foreign exchange dealers and the analysts who support them. Because rates fluctuate, there is potential to make money out of guessing future market movements: if the dollar is going to be more expensive tomorrow, it is worth buying relatively cheap dollars today and selling them again tomorrow at tomorrow's higher price. There is of course at least equal potential to lose money because rates are guessed wrongly. A number of international banks in London have withdrawn from own account trading because of the difficulty of achieving any consistent profit.

It may also be helpful to distinguish two types of currency fluctuations, even though individual transactions cannot be divided neatly between the categories. Over a long period, changes in the exchange rate between two countries will reflect mainly the changes in the relative strengths of their economies. Currency traders may study the internal economies but cannot be considered as a major driving force on them. On top of these long term changes, there will often be the "froth" of very temporary movements in exchange rates with very little relation to any fundamental shifts in the home economies. Sometimes these can be driven by traders' opportunism as they see scope for a quick profit by exploiting a temporary fluctuation from trend. Such opportunities may be more likely to occur with the less frequently traded currencies of smaller economies. This latter form of currency trading, which is perceived as simply making money out of money, attracts the moral outrage of some Christians.

In principle, such speculative dealers serve two valuable purposes in the foreign exchange market. Firstly, typically they are buying dollars when others are selling them, and vice versa, so they can reduce the size of net sales or net purchases of a currency and thus dampen down price fluctuations. Secondly, they ensure that there is always a flow of deals taking place in the market so that those needing a particular currency for trade transactions can always find a willing seller of that currency.

A key question behind the Tobin debate is whether moral outrage at the speculation froth is justified by calm analysis or whether this speculation is, on balance, beneficial given current market structures. Over a long period the proportion of foreign exchange deals which are speculative rather than related to trade has been growing. The continuing trend towards bank mergers and larger market players has led to larger dealing rooms on average, with each having more need to be active as a profit centre in its own right in order to justify capital costs. As the balance of activity swings more towards speculators who are second guessing each other rather than just economic fundamentals, the more the market is suspected of taking on a life of its own with little regard for economic fundamentals. Hence there remains a view that foreign exchange dealing is socially undesirable and a suitable activity for special taxation. Many working in the financial world regard this view as distorted.

A second feature of the foreign exchange market relevant to Tobin is that it is an unusually "pure" market in the sense that it meets the theoretical criteria for an efficiently functioning market and therefore delivers the benefits of a free market. For example, the information available to market participants is exceptionally comprehensive as a result of huge investments in technology. For those predisposed to believe that market capitalism always delivers net benefits to society, the pureness of the foreign exchange market will be a reason to avoid government interference with it. To those predisposed to believe capitalism is an essentially immoral system, the pureness of the exchange market will make it a prime target for attempts at government restriction. Many Methodists will take a more central position. They will accept that the capitalist system is the least bad option for the ordering of the economy but still feel a particular anxiety about the apparent ease with which money is made on the financial markets without clear benefits to society at large.

A final relevant feature of the foreign exchange market for British Methodists is the pre-eminence of London. Turnover in London is typically around $700bn a day (or £450bn a day; or roughly the entire Connexional Team annual budget every second). This represents a third of global activity. In approximate terms, it is twice the level in the USA, four times that in Japan and eight times that in any other European financial centre. If any national Church were to lead a campaign to tax this market, it would be natural for it to be a British one.

The Campaign

The British campaign for Tobin is led by War on Want. Understandably, their campaign literature does not attempt to incorporate any lengthy and detailed analysis. It is optimistic when considering the benefits of a Tobin tax and minimises the difficulties. It has achieved attention in Parliament with a debate in the House of Lords in June 2000 initiated by Lord Judd, formerly Director of OXFAM. In the Commons, Tony Colman, a backbench Methodist Labour MP with a record of creative and thoughtful ideas on fiscal policy, led an adjournment debate in July. In essence, the Government's position is to recognise both arguments in favour and against such a tax and thus to welcome further discussion of the Tobin Tax idea without making a commitment to supporting it.

The campaign is also an international one. The most significant formal expression of support for a Tobin Tax was a vote in the Canadian Parliament in April 1999, which had the backing of the Finance Minister. It sought the introduction of a tax "in concert with the international community". Canada is a member of the G8 but not in the Premier League of foreign exchange centres. The Prime Minister of India and the SDLP in Northern Ireland have also expressed support.

The campaign within the Methodist Church appears to be built at present on a narrow base. The three Memorials sent to Conference (from the London (Streatham and Dulwich) Circuit Meeting and the London South-East and the Oxford and Leicester Synods) came with overwhelming support. Debate at the Conference, however, was brief. As the Circuit Memorial makes clear, the primary resource available at that period was supplied by War on Want. More detailed experience of the foreign exchange markets was not drawn upon directly at the Conference.

The Claims

Those presenting the case for Tobin build on the assumption that the foreign exchange market activity is unwelcome to thinking Christians, claiming that only 5% of deals are "necessary". They argue that over time the markets have become more volatile because they are less closely regulated than previously and because speculative traders themselves go through irrational mood swings. Simultaneously, aid to developing countries has fallen and, in combination, these factors make it a good time to dampen down the markets by taxing them and then giving the proceeds to the poor nations.

They propose a tax rate of between 0.1% and 0.5%. They say this is "small", even though it is very large compared with the return made on most wholesale money market transactions in major currencies. Because they believe it to be "small", proponents argue it would have no discernible effect on underlying trade. Nonetheless they believe it would be sufficient to have a significant calming effect on market volatility and the adverse effects of that on national economic management.

Proponents recognise that to prevent massive avoidance in a geographically mobile market, the tax would need to be applied in all key financial centres. They suggest however that once a handful of the major centres were included, avoidance and evasion would be small enough to have a workable regime. For consistency, the tax should be instituted through an international agreement supported by national legislation.

They calculate that a 0.25% tax would raise $250bn a year. National collection agencies (which they suggest should be central banks not tax authorities) would hand over the proceeds to a United Nations body for use in international development. If a sum as large as $250bn were to be made available, on some measures it would represent a tripling of the resources made available by rich countries to developing economies and those in transition.

Advocates of Tobin also argue that the damping effect on market volatility would have a direct benefit to poorer nations through reducing the chances of a confidence crisis in particular countries such as affected many Asian countries in late 1998. They acknowledge that other measures would be needed in parallel. Some advocate a more complicated tax where a basic rate would be levied on transactions in normal times with a penal rate introduced in times of exchange rate turbulence. They argue the penal rate would discourage further currency trading and help the restoration of stability to both the markets and the economies.

Supporters of the tax assume that funds driven away from the currency markets by their regime may move to "more productive investments". They accept that a reduction in currency market activity would cost jobs in the City but argue that the cost is more than offset by the benefits for people in the poorer countries from the disbursements of the tax proceeds. Furthermore, if greater currency stability meant fewer crises in, eg, Asian economies, there would anyway be trade and employment gains for Britain from an improved and more consistent demand for our exports.

Supporters of Tobin also sometimes present their campaign as a comparable one to Jubilee 2000's advocacy of debt relief. They suggest that the degree of success achieved by the latter demonstrates the potential for the Tobin campaign to succeed too.

Assessing the Claims

a. Curbing Speculation

There is no absolute measure of when the volume of exchange transactions becomes too heavily weighted towards speculation. Tobin supporters are undoubtedly correct in claiming the balance has swung towards speculation. The more useful and interesting question is why this matters. There are those who find it offensive that people should make money out of money in the wholesale money markets, although they do not always articulate why this is more sinful than making money out of apples in the wholesale fruit market. A small number of well-publicised cases have yielded profits that are huge by any standards; perhaps a major stimulus for the concern is the discomfort many Christians feel about great wealth per se or the power that comes from large commercial operations, whether they be banks or oil companies. This might argue for higher and more progressive corporate taxation generally but does not necessarily point to targeting currency dealings.

Apart from those who object to people making money out of financial markets, currency speculation would only seem to be a clear cut and peculiar moral problem for Christians if it leads to exchange rates that are in some sense "wrong". As the "right" rate at any given time is a judgement and not a discernible fact, this supposed distortion is usually hard to prove. It is not enough to demonstrate that the rate is different from what it would have been without the speculators, as the latter, being professional market watchers, could be better at assessing the "right" rate than those engaged in trade transactions. Those who accept the basics of the capitalist system may therefore find it hard to identify robust grounds for objecting to ordinary day-to-day market speculation.

A prominent element in the Tobin debate, however, has been the impact of the currency dealers in unusual times. Here the picture is different and raises more obvious moral issues. Currency markets and their effects hit the headlines when there are significantly more sellers of a currency than buyers. In that situation, governments may seek to support the value of their currency by spending their foreign currency reserves to enter the market as buyers of their own currency. In practice, few countries nowadays have the reserves to do this to a sufficient extent to offset a determined mood change among the professional dealers, whether or not this is justified by changes in the underlying economy. So the likely outcome is that the value of the unwanted currency will fall relative to other currencies, and possibly dramatically: a "run on the currency".

Currency crises are not new. It is nonetheless indisputable that a heavy preponderance of speculators with the technological capacity to execute very rapid decisions can cause a loss of confidence to spread very quickly, not least around the globe, and make it much more difficult for any response to be considered in advance of exchange rates moving sharply. As the new exchange rate affects all external transactions for the economy concerned, including the value of the nation's reserves, this can be seen as an immoral rape of value by exchange market speculators.

The Tobin campaigners are in line with the G8 and others in believing that the rate at which Asian currencies lost value during the 1998 crisis was an example of this process and inherently undesirable. Therefore, they would all argue, the world should find ways of avoiding a repetition.

While the objective looks admirable there are severe doubts about whether, at such a critical test moment, a Tobin tax would actually help. During a serious currency run, exchange players have decided to exit a currency for fear of a major loss of value if they continue to hold it. Even if the Tobin tax could be engineered to be imposed at a higher rate in crisis times, it seems highly unlikely that this transaction cost would be so great as to make it worth holding a failing currency rather than selling it. The tax would therefore have no effect on the rate of exchange the market reached or on the damage done to the victim economy.

Some of the more analytical proponents of the Tobin tax have accepted this weakness. In a Fabian Society pamphlet sympathetic to the Tobin campaign, Grieve Smith nonetheless concludes "the taxÉ.would not be an effective antidote to speculation on major changes in exchange rates" (Closing the Casino Fabian Pamphlet 597, 2000 p13). The idea that a Tobin tax would be a major help to weaker economies at the moments of greatest crisis is deeply flawed.

b. Feasibility

As proponents recognise, the international nature of the financial markets means an effective Tobin tax would need to be international too to avoid easy evasion. Without this, a major financial centre, eg London, which imposed the tax would simply be inviting the highly mobile foreign exchange market to move elsewhere, reducing further domestic influence on its behaviour (as well as exporting jobs).

The proposal that only a few key centres need impose the tax seems optimistic. The growth of offshore business in a variety of other financial markets provides a warning that imposing extra costs by regulation or otherwise in traditional centres is likely to lead to a major exodus of business. Any Tobin tax rate high enough to have an impact on behaviour would therefore risk business moving unless it was imposed globally.

Only optimists would feel confident that all the governments just of major financial centres could reach agreement on a specific tax proposal. Only extreme optimists would feel confident they would also manage to agree on standard terms and rates for such a tax. Without these certain centres could, ironically, use a tax designed to dampen activity to entice more activity to their own jurisdiction.

There is the further difficulty of defining which transactions to cover by the tax. While the examples used in this paper are only about simple simultaneous exchanges of two currencies (bilateral "spot" transactions), the markets in practice have developed a wide range of more complex arrangements. Many of these are very important for those trading in goods, because they allow them to buy certainty about the future prices in their own currency of their imports or exports. The next tier of facilities involves future promises to buy or sell at particular rates if certain triggers are activated ("futures" and "options") while even more involved instruments combine elements of various types of deals, not necessarily all of them on the foreign exchanges at all. Some of these more complicated financial instruments were specifically designed to avoid various existing attempts to add costs to market transactions. There is not therefore a straightforward boundary defining the transactions relevant to Tobin.

As with any tax, there is also scope for debate about the appropriate rate. Tobin illustrated his original proposal with a 1% rate. Recent discussions have mostly suggested 0.25%. These latter figures are sometimes put forward as being so minimal they could not seriously disrupt non-speculative transactions. It does need to be remembered that the anticipated profit margins on exchange transactions are normally tiny in percentage terms, even if occasionally substantial in absolute terms. So a levy of 0.25% would be a very large addition to the cost of dealing. Whatever the rate, and whatever the assumptions about the response of the market players, it cannot simultaneously be the case that the chosen rate is both so large that it achieves a dramatic calming effect on the markets and so small that it has no significant impact on transaction costs.

None of these severe practical difficulties necessarily mean it would be wrong for a Church to take what it believed to be a principled stance and expect a long and difficult battle to win acceptance by decision takers. The point is simply that nobody should imagine the imposition of a Tobin tax is similar to establishing a new domestic tax. It would be far more difficult to negotiate; indeed it would be without any precedent in history. It is debatable whether devoting the energies of the Methodist people to such a campaign is really the best way to express concern about the world's most vulnerable economies.

c. Impact on Third World Development

A Tobin tax would apply indiscriminately to currency purchases for productive investment in poorer countries and to speculation. Whatever impact it has on the level of speculation has to be assessed alongside the detrimental effect it would have on investment. Even if the tax were feasible and effective in its main aim, it would not therefore represent unequivocal good news for weaker economies.

A much more prominent point in the promotion of the Tobin concept has been the scope for using the proceeds for international development. Indeed a study for Oxfam (Time for a Tobin Tax? Some practical and political arguments by Stecher with Bailey; Discussion Paper 1999) concluded that the argument for Tobin as a stabilising mechanism was too weak to "merit the limelight" and it was only the revenue possibilities that justified a campaign in its favour.

The idea of devoting Tobin proceeds to international development raises questions of principle about the hypothecation of revenues from specific taxes for specific purposes. Some Christians do find this idea attractive while others are concerned that conceding this principle would in fact make it much harder to raise taxes for politically unpopular, but moral, social causes.

If the Methodist Church wishes to take an informed view on the hypothecation principle it needs to discuss the issues on their merits. Perhaps it is sufficient here to note two points. Firstly, tying the Tobin debate to hypothecation will make the concept even less attractive to many in the UK Government, especially ministers and officials in the Treasury. Expecting global assent to this additional feature of a Tobin tax would make any chance of agreement even more remote at a time when many governments show no inclination to use other additions to tax revenues for overseas aid. Secondly, if Methodists believe in greater taxation for overseas development on moral grounds, it might sound a more convincing plea if they argued for some of this to come from forms of taxation to which they will themselves be subject along with other citizens. A rise in income tax would be a great deal easier to administer.

Most Tobin proposals also suggest the proceeds of the tax should be handed over to an international agency, such as the United Nations, for distribution. While this has attractions in principle, it might not help win political support for the tax. Governments will not find attractive the notion of handing responsibility for the disbursement of funds, and any associated credit, to an external body. In addition, there are varied opinions on how efficient the international agencies have been in the use of resources made available to them in the past.

Although all these question-marks can be raised about the use of any Tobin tax revenues for international development, it is important to recognise that the basic issue on this point is political will. Unlike some of the doubts about the ability of the Tobin tax to change currency market behaviour in the ways claimed, the distribution questions do not raise any major technical problems. If government will existed around the globe, the proceeds of a Tobin tax (or any other tax) could be distributed for international development.

In some places the link to social and economic development is also used to build a bridge in people's minds to the Jubilee 2000 campaign. It is certainly true that Jubilee 2000 managed to grasp a potentially confusing economic issue and motivate Christians to campaign with vigour and confidence. Furthermore it achieved results. The Tobin campaign in reality has as many differences as similarities with the Jubilee 2000 one. It is harder to find any direct Biblical basis for the proposed Tobin action. Jubilee 2000 focused on a concept that was easy to understand by parallels with ordinary household transactions. Jubilee 2000 targeted some readily identifiable transactions. Jubilee 2000 could achieve results even if only some countries responded and only partially. Jubilee 2000 plans had a direct impact on vulnerable countries, not an artificial one via hypothecation.

Underlying Concerns

This paper has argued that there are very serious faultlines in some of the Tobin tax campaigners' claims and that even the most basic and limited Tobin tax would be far more complicated to establish and operate than they acknowledge.

Nevertheless, even for those inclined to see the Tobin campaign as misguided in detail, it does provide a wake-up call on some issues that a wide spectrum of Christians would feel were matters of justice relevant to the Gospel. There may be achievable and useful targets for the Methodist Church to set in raising awareness of some of these.

Firstly, the Tobin debate highlights the growing problem of government regulation trapped within national jurisdictions trying to control international players freed from national boundaries. This is particularly acute and obvious in financial services because technology makes them highly mobile, and the major providers are global organisations with experience of controlling operations in many countries simultaneously. Whatever its other failings, one of the achievements of the EU has been to bring an unprecedented, if still limited, degree of harmonisation to technical aspects of regulation. This reduces the scope for international companies to play one national government off against another within Europe. In some instances it also allows global co-ordination to be reduced to trying to win consensus from only three entities (the USA, Japan and the EU).

Secondly, the Tobin debate highlights the serious damage that currency panics can do not just to the financially sophisticated, who could be deemed to take their risks knowingly, but also to ordinary people, not least in countries with low income levels. This is rarely the aspect of global financial hiccoughs that receives most media attention and, even if it is mentioned, the publicity fades more quickly than the problem. Christians concerned for all their neighbours do not need to understand all the details of the global financial transmission mechanisms to show active concern for the victims.

Thirdly, a balanced Tobin debate ought to lead to a recognition that there are no simple solutions to occasional, serious instability in foreign exchange markets. In his original lectures, James Tobin was clear that his tax would not remove from governments "the imperative necessity to co-ordinate policies more effectively". Particularly since the 1998 Asian crisis, there is a greater awareness amongst central banks and their governments that preventative arrangements need reinforcing to avoid reaching the point where markets panic and speculators hasten problems. Governments know that attempting to control markets once confidence is lost is scarcely realistic, either by taxation or exhortation. Given that this is a debate to which the major economic powers are committed, some informed, constructive engagement by the Churches is likely to be a useful spur and conscience prick, as were Jubilee 2000 protests on debt relief.

A Way Forward

The recommendation of the Connexional Team, in responding to sub-section c) of the Conference resolution (Daily Record 7/17), is that the Conference should:

i. recognise the urgent need to reform the global financial system, given that the gap between the rich and the poor countries continues to widen;

ii. within this overarching concern, encourage well-informed and careful discussion of the proposals relating to the Tobin tax;

iii. offer this paper as a resource to assist such a discussion.

The Team will make copies of the paper available on request. The Team will also encourage ecumenical partners to discuss the issues in the light of the many considerations summarised in this paper.

There are no particular financial or equal opportunities implications of this paper. It does not lead to any changes in Standing Orders.

*****RESOLUTIONS**

(a) The Conference receives the Report.
(b) The Conference endorses the recommendation set out in 'A Way Forward'.