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## **International Taxation** **Regulating Globalisation – Financing Development**

**Peter Wahl**

Imprint

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Regulating Globalisation – Financing Development

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## Summary

International taxes have recently become a broadly debated topic, because it became obvious that achieving the UN-Millennium Development Goals (MDG) would need a huge amount of additional financing. The WEED-Brochure “International Taxation: Regulating Globalisation – Financing Development” debates the potential of international taxation for financing sustainable development as well as regulating globalisation.

International taxes are a completely new paradigm. Their realisation is an innovation of historical significance because until now, taxes have been firmly linked to the nation state. However, the process of economic globalization reveals the need for international taxation. As a consequence of the transnationalisation of economics and communications, new possibilities have emerged to create profits. For instance, through speculative gains on currency fluctuations, internal trade within transnational corporations, electronic trade or the enormous growth of international aviation or maritime transport.

At the same time the process of globalization produces loser and accelerates the widening of the gap between rich and poor. Nearly half of humanity is extremely poor with an income of less than two Dollars a day. In the year 2000 the United Nations committed themselves to the MDGs that primarily aim to halve poverty until 2015, increase health and improve education. International taxes can absorb a part of the gains from globalisation and redistribute them to the losers of globalisation, e.g. to finance the MDGs.

### **The Need for International Taxation**

International taxation is necessary, because globalisation leads to an erosion of national tax systems. Global players and international investors use liberalisation and deregulation, tax loopholes and tax havens to save taxes on a large scale. Currently we are experiencing a re-feudalisation of tax systems, i.e. the economically powerful pay less and less and the tax burden on middle and lower incomes increases. This leads to a permanent structural crisis in public finances and a massive redistribution from below to the top. However, the production or maintenance of global public goods like environment, education, health, etc. requires additional financial resources. International taxes can play a major role in regulating and shaping globalisation, both with regard to their steering effect, for instance ecologically, distributively or regulatory, as well as through the tax revenues themselves. Contrary to the widespread belief of taxes being “evil” we insist on their role as a counterbalance to the “free market” and as an instrument for enforcing social justice and ecological sustainability.

In relation to this, the legitimacy problems of international taxes are discussed (“no taxation without representation”). Referring to Habermas we argue that economic globalisation leads to an erosion of democracy on the national level. Therefore, international taxes are seen as a means to regain options democratic decision making for democratic nation states. In this way, international taxes can derive some of their legitimacy without the existence of a democratic representation on the international or even global level.

### **International Taxes for Financing Development**

The advantages of taxes in comparison to traditional development aid are also shown. For example, its potential to access adequately high sums, to guarantee a comparatively reliable and calculable flow of funds and to maintain efficiency.

Additionally, questions concerning the structure of international taxes are discussed, such as tax base, tax rates, expected tax revenue, levy methods, usage, determination of purpose, and conditionality. The possibilities go ahead introducing international taxes on a regional level, e.g. in the European Union, are evaluated and welcomed as a way to give the idea a momentum for discussion on the global level.

The WEED-Brochure analyses a wide range of proposals for international taxes concerning strengths and limitations. The main focus lies on the two-tier currency transaction tax (CTT)

in form of Spahn's modifications of the Tobin-Tax. Environmental taxes are another important contribution, they include taxes on CO<sub>2</sub>, kerosene, air plane tickets and tolls on the use of air corridors. Furthermore, duties and taxes on emissions and dangerous goods in maritime shipping and taxation on sea straits are analysed.

Less well known proposals are also presented, like the taxation of transnational corporations, of banking secrecy, and of offshore centres, the taxation of the international arms trade, secondary trade with stocks and shares, of investment portfolios and direct investment, e-commerce and luxury goods as well as global public goods, such as outer space close to Earth and electromagnetic fields. The British proposal of creating an international finance facility (IFF) is assessed critically.

### **International Taxes are Necessary and Realistic**

Despite the permanent failure of previous attempts to adequately finance development it is argued that international taxes and especially the CTT can make a difference. The following crucial factors are mentioned:

1. The Belgian parliament passed a law for a CTT, which can be adopted by other countries or the EU.
2. Leaders from important industrialised countries, like Chirac and Zapatero support the idea of a CTT.
3. For the first-time an increasing number of studies by independent scientist, government commissioned and international organisations confirm the feasibility and desirability of international taxes. The most important ones are the Landau-Report for the French president and the Spahn-Report for the German ministry of economic cooperation.
4. The topic of the CTT and international taxes is now even on the agenda of the IMF and World Bank.
5. Structural factors favour the realisation of international taxes, among them the failure of neo-liberalism in development policy, the structural crisis of state finances in industrial countries, strategic differences of interest within the G7, the increasing power of developing countries in the international arena, as well as the increasing role of social and global justice movements. It seems that a "window of opportunity" has been opened for the implementation of international taxes.

To use this opportunity different kinds of taxes should not be pitted against each other but seen as complementary instruments. An important aspect is linking the discussion to the development dimension of the topic with interests within the industrialised countries, such as tax justice and neutralisation of tax havens, and generally the political regulation of globalisation. It is also crucial that current and real policy opportunities are linked with long-term perspectives and a vision for global justice and solidarity. The democratic implementation of international taxes and their socially just design depend on constant pressure from the global justice movement and a broad discussion in the global community.

# 1 Hamster in a Wheel? On the History of Development Financing

*"We should fight to eliminate poverty by the end of this century"*, Robert McNamara, US-Defence Minister during the Vietnam war and afterwards President of the World Bank, formulated this objective in 1973.<sup>1</sup> He meant by the end of the 20<sup>th</sup> century that ended 5 years ago. As we all know, this aim was not achieved (see Box 1).

## 1.1 The Notorious Crisis of Development Financing

Another famous goal of development politics also failed: setting 0.7% of Gross National Income<sup>2</sup> of the industrial countries aside to finance development. In 2005 we will witness the 35<sup>th</sup> anniversary of non-achievement of the UN resolution of 1970. The trend has even been that this amount has been decreasing for more than ten years. Official development aid (ODA) fell from its peak of 0.33% in 1992 to 0.23% in 2002.<sup>3</sup>

Even if development cannot be seen as only financing and its amount, and despite the justified criticism of structure and procedures of current aid:<sup>4</sup> the providing of money and the amount made available are still the best indicators of how much significance a political aim has. Comparisons with other political areas are especially very instructive. The increase in US defence expenditure after September 11<sup>th</sup> amounted to 48 billion USD, i.e. nearly as much as the total public development aid, ODA, of industrialized countries for 2001 (52 billion USD). If an issue is not just rhetoric but actually becomes a political priority, then financial resources are mobilised for it. The height of ODA is an indication of the seriousness of the development rhetoric in industrialized countries.

Other action plans for reducing poverty have similar experiences to the 0.7%. Who still remembers the Agenda 21? This was the action programme of the UN Conference for Environment and Development (UNCED) in Rio 1992. After the end of the Cold War, UNCED was the great hope for change. At last, the "peace dividend" from the end of the Cold War was to flow into sustainable development. An additional 125 billion USD was to be mobilised to solve the most pressing problems of environment and development. This was an amount of 0.7% of global GNP. The developing countries demanded the establishment of a Global Development Fund. The outcome was the Global Environment Facility (GEF), funded with an average annual budget of nearly 1 billion USD, and it has to fight for its replenishment every three years.<sup>5</sup>

And what happened to the "20:20 Initiative"? This was a proposal at the World Social Summit in Copenhagen in 1995, according to which the donors were to provide at least 20% of their ODA, and the beneficiaries 20% of their state budget for human development priorities<sup>6</sup>. The FFD Process (FFD = Finance for Development), that came about in the follow-up to the Rio Conference and which led to a World Conference in Monterrey, Mexico, in 2002 also failed to produce tangible results. Stylishly called the Monterrey Consensus, as an alternative to the neo-liberal Washington Consensus, many proposals of the Nineties debate were again summarized, from cancellation of debt, an increase in ODA to an International Finance Facility (IFF) as well as international fees and taxes. However, any attempt to sharpen and solidify the process was blocked by the industrial countries – mainly the US. The final document contains assessments, recommendations and commissions for

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<sup>1</sup> Cited after Sachs (2000).

<sup>2</sup> Term until 1999: Gross National Product (GNP).

<sup>3</sup> Cf. OECD: (2004).

<sup>4</sup> Cf. e.g. Martens (2001).

<sup>5</sup> Cf. Wahl (1997).

<sup>6</sup> Food, drinking water, sewage, basic education, basic health including reproductive health and population policy.

review - but no binding promises, whether for increasing ODA or for any other financing instrument.

### **Box 1: Half of Humanity is Poor**

#### **Absolute Poverty**

1.2 billion people live in absolute poverty. This is a fifth of the world population. Absolute poverty is defined as income poverty, the poverty level being at an income of less than 1 US Dollar per capita and day. Poverty below this level means an everyday struggle for physical survival for those affected. It also means: no medical care, no access to at least basic education, no access to clean drinking water and safe sanitary facilities. It means a low life expectancy and hardly any chance to escape a life of misery and distress.

This definition of poverty does not by any means imply that an income above this level would represent wealth. Even twice the income of 2 US Dollar still means absolute poverty. A further 1,6 billion people have to survive with an income below this level. Therefore, a total of 2.8 billion people live in absolute poverty<sup>7</sup>. With a world population of 6.2 billion this amounts to 45%.

#### **Relative Poverty**

Even this number does not adequately depict the reality of poverty. A complex definition of poverty cannot be reduced to absolute poverty, even if this is the most dramatic dimension of the problem. There is a consensus in poverty research that poverty cannot be related to the physical minimum of existence alone but has to be related to the overall social and cultural context of society. "Poverty is seen as a social discrimination related to the average standard of life."<sup>8</sup> The World Bank defines relative poverty in developing countries as a third of the average consumption. According to this definition, more than half of the population in Latin America and Sub-Saharan Africa lives in relative poverty.

Since relative poverty is also an increasing problem in the industrialised countries, among them Germany, based on the average poverty level of the EU of 15%, another estimated 150 Million people from the North would join the masses of the poor. Overcoming absolute poverty would signify a first step to solving the problem but the entire problem would not be abolished.

However, it was decided in a follow-up conference in Monterrey (September 2005) to evaluate the progress in implementing the Millennium development goals (see Chapter 1.2.).

## **1.2 The Millennium Development Goals**

The currently debated action plan involves the so-called Millennium Development Goals (MDGs). At a UN General Assembly in 2000 it was decided to achieve the following development goals by 2015:

1. Reduce extreme income poverty (1 Dollar criterion) and hunger by 2015 by half (Base year 1990).
2. General primary school education for all children of the world.
3. Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015.
4. Reduce the mortality rate among children under five by two thirds.
5. Reduce the maternal mortality ratio by three quarters.
6. Fight HIV/AIDS, malaria and other major diseases.
7. Integrate the principles of sustainable development into country policies and programmes:
  - reverse the loss of environmental resources;
  - reduce the proportion of people without access to safe drinking water and sewage by half;

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<sup>7</sup> Cf. World Bank (2001): p. VI.

<sup>8</sup> Cf. 2nd Poverty Report of the Federal Government of Germany (2005): p. XV.



- achieve significant improvement in the lives of at least 100 million slum dwellers by 2020.
8. Develop a "global partnership for development", for example:
- advancement of an open trading and financial system that is rule-based, predictable and non-discriminatory.
  - address the least developed countries' special needs;
  - enhanced debt relief for heavily indebted poor countries;
  - develop dignified and productive work for young people;
  - provide access to affordable and essential drugs in developing countries in cooperation with pharmaceutical companies;
  - use the benefits of new technologies, especially information and communications technologies

As we can see, the targets for poverty reduction in the MDGs are much less ambitious than those agreed on in McNamara's times. The concept also has more questionable aspects (see Box 2). However, it provides an anchoring point for justifying and developing the theme of international taxation.

### **Box 2: The questionable aspects of MDGs**

The MDGs have an immense moral authority in public opinion. Who would want to argue against the reduction of poverty? However, the programme also has its questionable aspects.

1. Firstly, the new modesty – praised by some as realism – to reduce absolute poverty (1 Dollar criterion) by 2015 only by half. A purely arbitrary fixation by which simply 600 million people are left to poverty in its worst form even after 2015, just like that, in the name of political realism. For the know-how and economic potential is available to make absolute poverty history altogether. It is exclusively a question of political will and therefore finally of power and domination. Whoever speaks of the moral authority of the MDGs should not forget that the MDGs are actually a declaration of moral bankruptcy.
2. In its concrete parts, the MDGs are reduced to finance transfers, while structural changes (see goal 8 above) are described vaguely and without obligation. This externalizes a large part of the structural causes of poverty. At the same time, the bankruptcy of neo-liberal theory and policy is disguised. They started out twenty years ago with the very aim of enabling wealth for all on the planet with globalisation.
3. By concentrating on aid transfers, the possibility of achieving fast and measurable development effects is forsaken, for instance with an unconditional debt cancellation for the group of poorest countries.
4. Some questionable compromises with neo-liberal mainstream have been built into the MDGs, for instance the co-operation with pharmaceutical TNCs for fighting Aids and other diseases. Instead of taxing corporations according to their capacity and providing vital medicine free of private profit-maximizing interests, this kind of PPP (Public Private Partnership) usually turns into Publicly Promoted Profits.
5. As long as the structural causes of poverty remain obscure, we will also remain powerless to prevent the creation of more poverty. About 2 billion people who today still live in rural areas and in a small farmer production relationship are subordinated to the profit interests of global capital and this is inexorably producing more impoverished masses. On the one hand, poverty is being reduced with financial transfers, and on the other hand, the existing structures are reproducing poverty.

The finances necessary for the realisation of MDGs were estimated in an extensive survey led by Jeffrey Sachs from the Columbia University in New York. According to this calculation, an increase in ODA up to 135 billion US\$ would be necessary until 2006, in 2010 to 152 billion and until 2015 by 195 billion. By percentage, this would signify an increase up to 0.44% by 2006, 0.46% in 2010 and 0.54% in 2015. The costs of the programme would still

remain below the goal of 0.7%. The same the Sachs Report – unsurprisingly – concludes that these aims could by no means be achieved if financing were to remain in its usual tracks. New instruments need to be developed. International taxation could ascertain a key role.

## 2 International Taxes

Modern political systems are basically based on two pillars: the state monopoly of power, as well as the state's ability to impose taxes and thus to finance the requirements of common welfare. The theme of the monopoly of power is not directly relevant to our topic.<sup>9</sup>

Therefore, taxes are primarily a central instrument to organize, structure and manage society. They are an indispensable contribution to the integration and cohesion of a society. Without taxes, modern and complex societies could not function. Taxes are not socially neutral in their concrete form and their effects. Depending on the power struggle between different social interests, they can either serve domination or emancipatory interests. In any case it is already an ideological shortening to reduce taxes to a merely microeconomic cost factor.

In times of globalisation, what applies to the nation state has to be transferred to world society: international taxes can play an important role for the regulation and management of globalisation. Their steering effect – ecological or distributive effects, for example – as well as the tax revenue are new instruments for politically guiding the globalisation process. Therefore, this topic is also an important contribution to the discussion of alternatives to neo-liberal globalisation.

The widespread opinion that taxes are an evil that needs to be abolished, therefore neglects their decisive social importance. It is one of the largest successes of neo-liberal ideology that taxes are generally discredited in public opinion, and to have created a public climate of pressure to reduce taxes – favourably to "zero taxes". By discrediting taxes as an instrument of social regulation, the dominance of market forces is strengthened, free of political interventions, among them taxes. An emancipatory perspective on taxes, however, defines itself as a counterbalance to the "free market" and as an instrument for enforcing social justice and ecological sustainability. With international taxes, this approach is part of a transnational regulation of the globalisation process.

### 2.1 Taxes finance Public Goods

The social integration effect of taxes is mainly created by the fact that they can finance the production of public goods. Privately and therefore through the market, public goods cannot be provided or only to an inadequate extent. For instance, education and information, health, environment, social security, culture and infrastructure are important public goods.

Meanwhile, the term public good has been transferred to the global level. The UNDP especially incited this debate in the 1990s<sup>10</sup>. The following are important Global Public Goods: peace and security, sustainable development, cultural diversity, a stable international financial system. The necessity to finance these goods that are not provided by the market is one of the main motives to introduce international taxes and dues.

### 2.2 Tax justice

Although mainly corporations, high-income earners and large assets benefited from neo-liberal policies of tax reduction, the mass of simple income tax payers was also motivated to join the offensive against the "tax state" and opt for tax reductions. The slogans for tax reduction are very popular, and therefore the tax rate (the tax earnings in relation to GDP) has decreased.

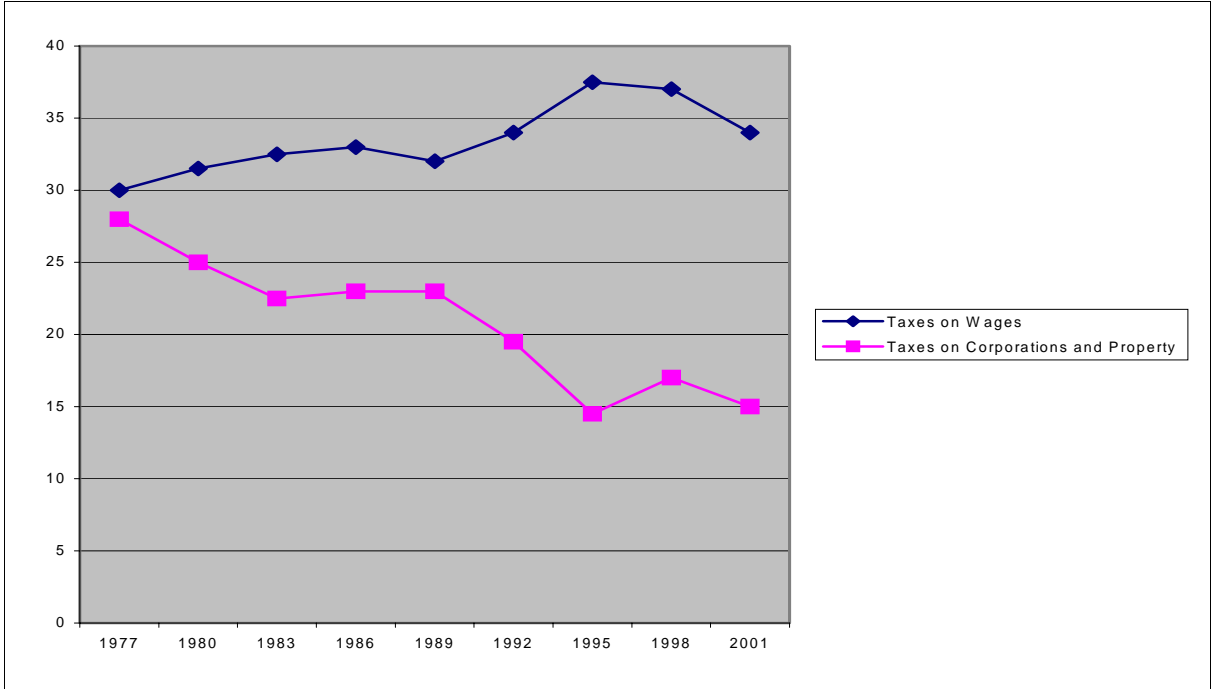
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<sup>9</sup> Nevertheless, there is a genuine direct connection between the two up until today. If someone refuses to pay their taxes, he or she can be forced to do so by means of state power, for example, prison. Tax evasion is a crime. On the other hand, the institutions which manifest the state monopoly of power – military, police, justice, prisons, etc. - cost money. In the case of the military, i.e. the state monopoly directed abroad, often even an exorbitant amount.

<sup>10</sup>Kaul (1999), critically Martens/Hain (2002).

However, if we look more closely, then we can reveal that only certain taxes have decreased. Between 1980 and 2000, the proportion of taxes paid by corporations and property has been reduced by half in relation to the entire tax revenue. At the same time, wage taxes have slightly increased despite long-term mass unemployment and correlating tax loss.

**Fig. 1: Quota of the Taxes on Wages, Corporations and Property**



Source: Giegold 2003

This means an enormous redistribution from poor to rich. This questions another basic principle of a modern definition of taxes: tax justice. Since the French Revolution, tax justice has been enforced as a normative orientation – even if not as successfully in reality - in all modern societies. Already article 13 of the legendary Declaration of Human and Civil Rights on August 26, 1789 on tax declares: *"It must be distributed evenly among all citizens considering their property situation."*

This marks a historical turning point. Its significance can hardly be assessed today. In the Feudalism of the Ancien Régime, the ruling classes, gentry and clergy, did not have to pay taxes. The fact that only the ordinary people had to pay taxes was one of the main driving forces of the French Revolution. Therefore, the trend towards zero taxes for global players is an equivalent to re-feudalisation.

The founding of the USA is also linked to an issue of tax policy: At the Boston Tea Party, citizens destroyed British Tea because the duties to the British crown were too high. The tax revolt was the signal for the struggle towards independence for New England. Of course, the proclamation of tax justice does not signify its practical realisation. The decision on the tax level and amount, what the taxes are raised for, and by whom is always the result of social power struggles. How have these developed under the conditions of globalisation?

### **Box 3: Taxes in History**

The German word for tax, "Steuer", is derived from the old German "stiura" and means support, allowance, aid. Historically, taxes are nothing new. Ancient times already knew the tax collector – usually paid with a share of the revenue – who demanded a tribute from the subordinated people and vassals, very often with violence. However, taxes were not raised with the efficiency and regularity we are used to today. Often, concrete reasons, e.g. financing a war, led to the tax, as a contribution to the war.

In Medieval times and until the end of the bourgeois revolution, a main feature of feudal power relations was that the lord owned the tax privilege to impose taxes on the subjects in his territory. In exchange (ideally), he granted security on his territory from outside attacks, and – since he also disposed of jurisdiction – a minimum of legal certainty towards the interior.

The taxes were raised first of all to finance the expenditures of the court, sometimes also infrastructural elements like paths and bridges. Quite often these taxes were not paid in monetary form but with labour services of the subjects. Additionally, the church demanded a tithe from the farmers, i.e. a tenth of their harvest. The tithe was also usually paid in kind.

In the cities, however, a tribute system was developed to finance the maintenance of infrastructure – canalisation, wells, street lamps, night watchmen, city walls, common festivals, etc. These were already forms of financing public goods like hygiene and security.

During Absolutism, taxes were increasingly centralised and used to finance the more and more luxurious court life and war adventures of the central state. A great amount of fantasy was applied to determine the tax base. There were taxes on linen, salt, like the notorious Gabelle in France, or the number and size of windows in a house, and also predecessors of today's motorway tolls, taxes on bridges and passages.

In Ancient and Medieval times, taxes were immediately linked to power, domination and privileges. With the bourgeois revolution and the establishment of parliamentary democracy, the democratisation of tax systems also began. From then on, taxes were subjected to being legitimised by the procedures of parliamentary democracy.

However, the norm was not enforced straight away and everywhere. For instance, in England, the vote was only granted to those citizens (exclusively men) who paid taxes, up until the 19<sup>th</sup> century. In the 20<sup>th</sup> century, with the emergence of the social state, taxes developed into an instrument of social policy and redistribution benefiting the lower classes. This tax policy is based on theories founded by Keynes.

In a historical perspective, a development can roughly be seen in three main steps:

- a. The tribute as completely one-sided burden for those paying it.
- b. The feudal tribute, with elements of external and internal security provided in return.
- c. Taxes to finance public goods, social integration and solidarity.

## **2.3 Taxes and Globalisation**

The tax systems that emerged in the 19<sup>th</sup> and 20<sup>th</sup> century were conceived for the nation state and its relatively closed economies. Capital and labour were more or less equally bound to territory. The national tax jurisdiction could determine the tax base more or less without any problems.

Globalisation created a new situation. Its economical core is the increasing abolition of nation state borders for the movements of capital, goods and services. Multilateral institutions like the WTO, IMF and World Bank exert a pressure worldwide, to abolish remaining barriers, duties, tariffs and other restrictions. In the interplay with the transformations within communication technology and the increasingly cheap transport possibilities, the value-added chain in production has also been internationalised.

Due to the abolition of capital transaction controls and other capital market regulations, no other production factor is as mobile as capital. Thanks to digitalisation and satellite communications, daily 1.9 trillion USD are transferred between the large financial centres.<sup>11</sup> Financial transfers can be carried out in real time at any time. A transnational space has emerged, and the activities of the global players in this space can decreasingly be controlled and regulated by nation state measures.

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<sup>11</sup> BIS (2004)

The mobility of the factor labour, however, is by far smaller. Humans are not as mobile as capital. This unequal mobility is the cause for the effectiveness of dislocation of manufacturing plants to other countries or even the mere threat of dislocation.

### **2.3.1 New Possibilities for Tax Evasion due to Globalisation**

All this has far-reaching consequences for the tax systems.<sup>12</sup>

- The liberalisation of financial markets has mostly abolished capital transaction controls at nation state level. At the same time, the possibilities to carry out financial transactions for the purpose of tax evasion or fraud have increased.
- Simultaneously, most nation states actively reduce taxes on corporation profits, capital gains and large assets. Globalisation allows highly mobile capital to move anywhere at any time to find the most profitable investment opportunities. In order to draw capital into their own economy, governments believe they can increase competitiveness by reducing taxes for investors. A tax race to the bottom is initiated that often ends up in a mere tax dumping race.
- Transnational corporations can distribute their profits and losses to the different locations with the most profitable tax conditions.
- Procedures like transfer pricing can create artificial profits or losses. For instance, a parent company can demand either too high or too low prices from the subsidiary company for intermediate products, services, patents, etc. To excavate these possibilities, the departments for tax “optimisation” are not only very big, but have developed into profit centres.
- Additional incentives for tax evasion and fraud are emerging through offshore banking centres and tax paradises, territories with either no or little finance and tax jurisdiction. The abolition of capital transfer controls and the new technical possibilities (electronic banking) has incited the massive expansion of these tax loopholes.

As a result, the tax base of the nation state is eroding because the revenue from corporation taxes and taxes on assets is increasingly depleting. This is one of the main reasons for the structural crisis of state finances. Since the so-called "austerity measures" lead to a lack of finances and, on a long-term basis, to the erosion of the social and material infrastructure, this causes enormous economical damage. Those who like to justify "austerity measures" in the interest of future generations, neglect that it is the future generations that will pay a high price if education systems rot, if the immaterial wealth produced by cultural institutions is destroyed by continuous budget cuts and abolition measures, if public investment into transport systems and the ecological transformation of society is lacking.<sup>13</sup>

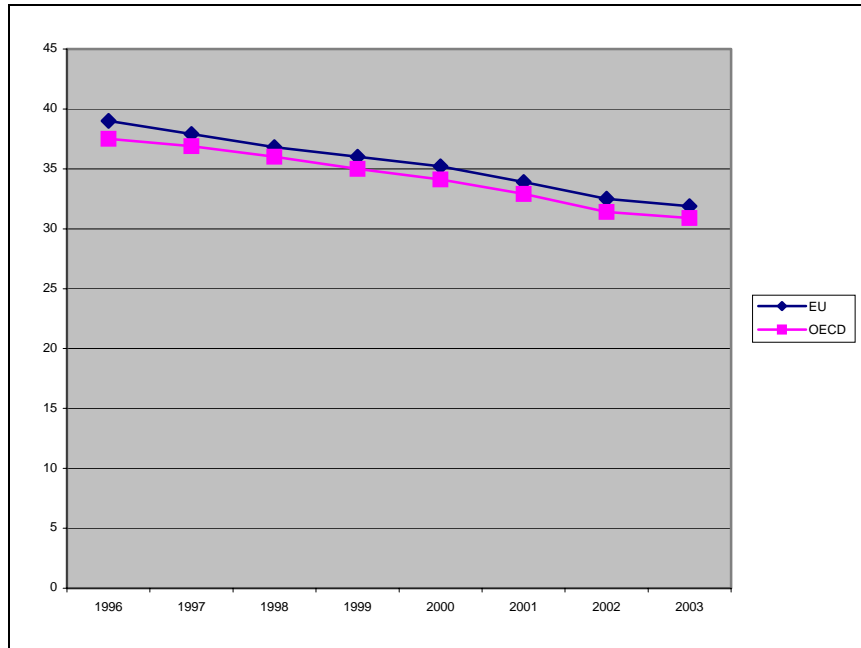
The impoverishment of public services due to the erosion of tax revenue leads to a second fault: wealthy people can react to the decline in public infrastructure by switching to high-quality and expensive private services, the lower income groups do not have this possibility. The justice gap is increasing.

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<sup>12</sup> Another dimension of globalisation, often neglected in the discussions within the social justice movement discussion, is closely linked to this: the erosion of parliamentary democracy, and parliamentary democracy is genetically and structurally bound to the territory of the nation state. Cf. Habermas 1994.

<sup>13</sup> Irrespectively, the thesis of the burden on future generations is also wrong in an economic sense since it only focuses on the debtors. Every Euro of debt is linked to a creditor who owns this debt certificate. Therefore, future generations will also know debtors and creditors and thus – like today – winners and losers. An adequate taxation of the winners could create a compensation. Therefore, it is not an intergenerational problem but a distributive problem – today and in future.

**Fig. 2: Reduction of the Corporate Income Tax in Industrialised Countries**



Source: OECD (2003)

The erosion of the tax base in the nation states due to globalisation is one of the causes of tax injustice. Unlike the global players, transnational corporations (TNCs) and owners of large monetary assets, the lower and average income groups, i.e. the vast majority of the population, do not have the same possibilities to evade taxes. Therefore, international taxes would not only be an instrument to compensate the erosion of the tax base of the nation state but also an important contribution to establish tax justice.

### 2.3.2 New Possibilities for Profits due to Globalisation

Irrespective of the fact that global players have found new possibilities for evading taxes due to globalisation, there is another very important reason that advocates the introduction of international taxes: globalisation has enabled new sources for entrepreneurial profits with a new quality. New sources of wealth have emerged that did not exist before. These are the opportunities of globalisation people like to refer to. In fact, as far as *business opportunities* are concerned, globalisation has not only created opportunities, it has actually created big winners.

Some of the profits can of course still be taxed on a national level without any problem. However, a large part of the profitable activities lies structurally beyond the grasp of nation states. These are mainly the following:

- Arbitrage<sup>14</sup> and speculative transactions carried out through the global cash flows. Due to the liberalisation and deregulation of financial markets, about 1.9 trillion (= 1,900 billion) US Dollar are currently transferred daily between the large financial centres across the globe. Benefiting from currency exchange fluctuations, interest rate differences and fluctuations of shares and bonds, a new type of yield has emerged. Even small currency fluctuations of one-hundredth per cent can turn into a million dollar deal if an adequate amount of financial input is invested.

<sup>14</sup> Arbitrage means benefiting from a known rate difference, for instance if a rate on close of the exchange in Frankfurt slightly varies from the opening rate in Tokio. Contrarily, speculators profit from future unknown price changes.

- Electronic trade through the internet with virtual goods and services. The internet enables the cross-border delivery of audio, images and texts on a commercial basis. Services were previously bound to a material data medium (e.g. CDs, video cassettes) and therefore detectable for customs and tax authorities or required the physical presence of the provider and the customer as a person-to-person service. These services are increasingly being provided through the internet. TV, film and video on demand, music, news, software and numerous consultation activities, as well as medical remote diagnosis, are creating new possibilities to earn money in a transnational way.
- The practices of TNCs, as mentioned above, to design the transactions between parent and subsidiary companies so that taxation is made very difficult.
- The externalisation of ecological costs that incur internationally, i.e. globally, such as the pollution of the atmosphere with emissions. This mainly applies to international transport carriers (planes, ships) that provide profits for their owners, and the environmental costs cannot be fiscally assigned to one country.

If somebody profits from globalisation this way then it is only logical that the profits should be taxed globally and used to finance environment, development and other global public goods. Therefore, the Landau Report defines e.g. an international taxation of TNCs as a "*counterbalance to the advantages they are given by globalisation.*"<sup>15</sup>

## 2.4 International Taxes – a Historically New Paradigm

Historically, international taxes are something completely new.<sup>16</sup> So far, taxes have been exclusively connected to the nation state. With globalisation, a perspective of their internationalisation is visible, since the necessary conditions have been created.<sup>17</sup> Like everything new, the concept first meets doubt and rejection, especially where interests are affected. However, there still are some open questions that need to be solved. The question of democratic legitimacy of international taxes is very important.

### 2.4.1 The Legitimacy of International Taxes

In democratic nation states, the legitimacy of taxes is ensured by the procedures of parliamentary democracy. Here again, the norm that is valid up until today was already set up by the Declaration of Citizens and Human Rights in 1789: "*All citizens have the right to determine, either themselves or by their deputies, the necessity of the public due, to approve them freely, to evaluate their implementation and their amount, their disposition, their collection and duration.*" (article 14). Summed up in a short slogan, often heard in this context, this means: "*No taxation without representation.*"

Since there has been no parliamentary representation beyond the nation state so far,<sup>18</sup> i.e. an international or global parliament, an international or even world state does not exist<sup>19</sup>, there is

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<sup>15</sup> Landau (2004): S. 16.

<sup>16</sup> Strictly speaking, a predecessor of international taxes already exists. The UN Convention on Maritime Law in 1982 regulates e.g. the utilisation of resources under the seabed in international waters. This includes a due to an international authority, its structure and function being defined exactly in the convention. Since the excavation of submarine resources has not occurred yet for cost reasons, this is a kind of "stand by-convention."

<sup>17</sup> The report of the North-South Commission chaired by Willy Brandt already contained a proposal to tax international trade, arms trade and exports or international tourism (Brandt Report 1981: p. 319). Paul and Wahlberg even find a reference to international taxes in 1884, in a book by the law scientist James Lorimer: *Ultimate Problems of International Jurisprudence.* (Paul/Wahlberg 2001: S. 4).

<sup>18</sup> This even applies to the EU where the process of supranational integration has advanced relatively fast. The European Parliament does not yet dispose of the full rights of national parliaments.

<sup>19</sup> Regardless of the fact whether this would be desirable.



no democratic legitimisation in the form of parliamentary representation for international taxes and correspondingly there is no foundation provided in constitutional or international law. This is an crucial fact that a proposition for international taxation has to deal with. If the principle of "*No taxation without representation*" were given absolute validity, any further discussion would be obsolete.

At first, therefore, it is correct that international taxes would actually not be possible on the basis of the traditional legitimacy of taxes. However, globalisation was also not foreseen. In those days, the territorial state was – and still is today – identical to the social space of parliamentary democracy. Since the territorial principle is put into perspective by the transnationalisation of economy and communications, this also has considerable implications for the functioning of parliamentary democracy. As we have already seen in the erosion of the tax base of the nation state, one of the main supporting pillars of the political system is destroyed. A part of sovereignty is lost, since the sovereign – in parliamentary democracy, this essentially is the voter, is deprived of the material means to form the community without being asked first. Therefore, sovereignty only remains on paper.

#### **2.4.2 Erosion of Democracy due to Globalisation**

The impairment of parliamentary democracy is not only caused by the loss of sovereignty due to the tax evasion by the *global players*. The economic power of transnational corporations, banks, funds and other institutional investors has also turned into an enormous political factor of power. Basically, the fact that economical power has a corresponding political influence is not new.<sup>20</sup> Due to globalisation, this has achieved a new quality. In the times when the concept of parliamentary democracy was developed there were no large corporations that could determine the welfare and woe of whole regions and of hundreds of thousands of people. "*Since the nation state has to organise its decisions on a territorial basis, a congruence between those involved and those concerned is decreasing in the interdependent world society.*"<sup>21</sup> If, however, the concerned are not involved in the decision-making on social developments then this no longer has anything to do with democracy. The former boss of the Deutsche Bank, Rolf E. Breuer, said this quite straightforwardly at one point when he described the financial markets as a "fifth power". Along with the legislative, executive and judicial power, he detects the "fourth power" of the media and then the "fifth power" of the financial markets: "*investors no longer have to comply with the possibilities for investment conceded by their governments, moreover, the governments have to obey the desires of the investors.*"<sup>22</sup> Governments share this view, as the German Foreign Minister, for instance, confirms. He was elected democratically but – being a political realist – he admits his own loss in significance, saying: "*We cannot do politics against the financial markets.*"<sup>23</sup> This description surely strikes a chord of reality. However, just like the media cannot claim democratic legitimacy, the actors on financial markets are neither elected nor democratically legitimised.

If another effect of neo-liberally dominated globalisation is the undermining of parliamentary democracy in its substance, then international taxes also represent a contribution to reallocate a piece of sovereignty and opportunity to the sovereign - the citizens – so that they can organise their conditions of life. This does not mean the complete solution of all the problems of democracy evoked by globalisation but a factor of democratisation. In times of globalisation, thinking democracy also in its global dimensions is inevitable. If the argument "*No taxation without representation*" does not want to lose its democratic substance that used

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<sup>20</sup> The connection of the British right to vote to the payment of taxes up until the 19<sup>th</sup> century is an example for this.

<sup>21</sup> Habermas (1998): p. 108.

<sup>22</sup> *Die Zeit*, 27.4.2000.

<sup>23</sup> Interview in *Frankfurter Rundschau*, 30.9. 2003.

to be its foundation then the new relations between globalisation and taxes need to be accounted for.

### **2.4.3 International Taxes Require Political Co-operation**

Especially since there are possibilities even short of a fully developed form of representation on international level to develop democratic forms of international regulation. Therefore, international taxes require co-operation. – By political co-operation between the states, by a democratic multilateralism. By a network of international agreements combined with national jurisdiction, as well as institutional arrangements, international taxes could be raised and invested into global community tasks. They would then be a crystallisation point for *global governance*, i.e. global regulation without a global state. With the equal participation of developing countries and the participation of organisations of civil society like trade unions, social movements and NGOs, the co-operation would represent a contribution to democratising the globalisation process.

Additionally, the Millennium Development Goals, despite their limitations, would not only enjoy a worldwide authority but also an acceptance at government level. These are also elements constituting a factor of democratic legitimacy below formal representation.

## **2.5 The Advantage of Taxes compared with Development Aid**

The Landau Report massively criticises traditional development aid. According to the report, ODA is too small, unstable and incalculable. Furthermore, aid is inefficient because of high transaction costs and the multiplicity of donor's interests.<sup>24</sup> In contrast, taxes could:

- Raise an adequate amount of funds;
- Guarantee a relatively reliable and calculable flow of funds, more or less enable an automatic flow of resources<sup>25</sup>;
- Ensure efficiency when a system has been established;
- Development financed through tax revenue would in principle signify a donation, unlike large parts of current ODA.

Additionally, there is another advantage, at least as significant: the function of taxes is not only to raise money. They often also function as a steering instrument. They can serve economic or social aims, i.e. they can serve two aims at once. Economically speaking, negative externalities can be abolished or compensated, and positive externalities can be created. A simple example is the tax on alcohol or tobacco. They reduce the consumption of drugs and thus also can achieve effects in health policy. The ecological tax is meant to reduce energy consumption and emissions and thus achieve an important ecological aim. A tax on foreign exchange could reduce instability at the financial markets and prevent financial crises, and a taxation of transnational corporations could influence the amount, aims and quality of investment. However, a successful steering effect could also lead to a reduction of tax revenue and even to its complete abolition. If this is not an aim or if there is a danger of new negative externalities, an adequate balance needs to be found between the steering effect and tax revenue. International taxes can also achieve such steering effects, e.g. an air traffic tax could reduce kerosene consumption and emissions.

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<sup>24</sup> The Sachs Report also made a very critical judgement on the ODA.

<sup>25</sup> Tax revenue can also fluctuate or generally disappear. Compared with ODA, however, taxes are more stable because the ODA has to be redecided every budget year.

## 2.6 Questions of Tax-Designs

If the basic decision for taxes has been made, then the concrete design has to be determined by the following main questions:

- Tax base,
- Tax rate level,
- Estimated tax revenue,
- Tax levy procedures,
- Utilisation, determination of purpose.

### 2.6.1 Tax Base

The first decision has to be made on the tax base, i.e. **what** is actually going to be taxed. Determining a general category, for example an *air traffic tax*, is not enough. Many things could be taxed with an air traffic tax, for instance the planes according to their technical quality (consumption, noise, emissions), their size or number of seats. Taxes could be raised on fuel, tickets or tickets of a certain price range or destinations (short distance or long-haul). There could also be a duty on the use of certain air routes or airports. Each of these possibilities could lead to completely different effects.

The final decision is usually the result of specific criteria and of the social power relations due to the multiplicity of interests that are connected to taxes. The most important determinants for selecting a tax are the following:

- Which steering effect is supposed to be achieved?
- What economical side-effects are likely to occur, e.g. distribution effects or distortions of competition?
- What potential – independent of tax level – does a tax have for the expected tax revenue?
- How significant are the possibilities for evasion?
- What political problems are connected to its acceptance or implementation?

International taxes also raise institutional questions and questions of international law. National taxes are already embedded in an established institutional framework (tax offices etc.) and there is a general tax jurisdiction. At an international level these do not exist yet.

### 2.6.2 Tax Rate Level

Several factors and their interdependence also have to be considered when determining the tax rate level. The balance between tax revenue and steering effect is fundamental. A tax on kerosene will have no steering effect if the tax rate is too low. A low tax rate would mean a stable income and even increment. If air traffic increases, however, the environmental advantage is lost. To achieve an ecological steering effect, the level has to be high enough to provide an incentive for airline companies to use more efficient and more ecological technologies. If a real reduction in air traffic is intended, the tax would have to be higher. This could also mean that the tax base is smaller since the revenue would be reduced if the tax rate would remain the same.

Simultaneously, a distributive effect would occur: Low-income groups would be affected to a larger extent, i.e. the tax would have a regressive effect. Contrarily, a tax on first and business class plane tickets would incriminate higher income, i.e. such a tax would have a progressive effect.

### **2.6.3 Tax Imposition and Institutional Aspects**

The procedures of tax imposition have been established long ago for national taxes. These include technical and administrative procedures for imposing taxes. For instance, the automatic deduction of wage taxes, forms of payment transactions (electronically or conventionally), automation, direct debit, etc.

An important question is the costs caused by the various procedures. If the cost of an imposition is unreasonably high, then the tax is economically inefficient. Also, the location of the imposition – e.g. in the case of taxation of interest rates at the time of credit of the interest rates (deduction at the source), possibilities of sanctions in cases of tax evasion, as well as questions of payment periods are further questions in this context.

An important question for taxation that has not been decided yet is the question which institution is to take care of the international taxes. There are several different proposals, and often the UN is mentioned. The UN could distribute the funds to various sub-organisations and specialised agencies like the World Health Organisation (WHO) or the UN Development Programme (UNDP) according to a ratio still to be defined.

The Global Environment Facility (GEF) is an already established organisation financing global goods. The GEF was founded succeeding the Rio Conference as a joint project by UNDP, UNEP (UN Environment Programme) and the World Bank. So far, the GEF only disposes of a small budget but it still is an interesting institution because it has decision-making procedures where neither donor countries nor beneficiary countries have the majority. This is a difference compared with the IMF and World Bank where the vote ratio depends on the capital input.<sup>26</sup> The principle of other organisations also does not apply: one country, one vote, leading to a majority of the developing countries in organisations with universal membership. The Belgian law for a currency transfer tax reveals another possibility. The revenue of this tax is meant to flow into a EU development fund.

The technical side of the tax imposition is likely to be unproblematic. Electronic data processing provides secure and cheap procedures of payment. With adequate programming, the income could be led to the appropriate institutions in a fully automated procedure.

### **2.6.4 Utilisation, Determination of Purpose, Conditionality**

The question of purpose specification usually does not arise with national taxes. One of the basic principles of tax policy is that the tax income is precisely not connected to a specific purpose. There is a good reason for this: Many tax-financed tasks that are necessary on a long-term and permanent basis would be in danger or could only be fulfilled insufficiently if they would depend on the frequent fluctuations in the revenue of specific taxes. If, for instance, the financing of the education system were linked to the corporate income tax, then this would be quite unstable due to the cyclical fluctuation of this tax.<sup>27</sup>

Meanwhile, national income taxes also show exceptions from this principle. For instance, the revenue from the German ecology tax is used for social spending. The contributions of EU member states to finance common institutions are financed from a ratio of the value-added tax. A factor of determination of purpose is also contained in the church tax raised by the state in Denmark, Germany and Switzerland. Therefore, the principle of separating revenue and utilisation is already not always strictly applied.

Since development financing, especially of the MDGs, is the main foundation for the legitimacy of international taxes, a determination of purpose is of course inevitable in this

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<sup>26</sup> This means that the USA owns over 17% of the votes (and therefore, a veto minority if the statutes are to be changed), Japan and Germany each own over 6% and France and Great Britain over 5% each. The industrial countries altogether have more than 50% of the votes.

<sup>27</sup> Regardless of the financing problems that evolve because of the decrease of tax revenue as a whole like due to the neo-liberal reduction of taxes for corporations and property.

case. This is also linked to the question of conditionality, i.e. the obligations that are connected to the payment of development aid. The obligation to actually use development aid only for development aims is a matter of course. Therefore, the use of international taxes would also be bound to this obligation. In practice, this will be relatively easy to manage everywhere where international organisations like WHO, UNDP, UNEP spend the money for exactly defined programmes, for instance a vaccination programme against Malaria or the fight against Aids. The participating organisations, state institutions, civil society or commercial organisations could be bound into a corresponding legal framework through a contract.

A more far-reaching conditionality as it has been applied under the “structural adjustment” in the past 20 years, however, would be counter-productive for development policy. Structural adjustment is an attempt to impose the neo-liberal model upon the developing countries. The same applies to attempts to link development aid to strategic interests like the “war on terrorism”.

### **2.6.5 Regional Introduction**

A large role in the discussion on international taxes is played by the question whether they cannot be introduced until a consensus has been established between all states and a worldwide implementation is made possible. This argument was raised especially often against the Tobin Tax. Since such a global consensus could not be reached within a reasonable time-frame, the project could not be carried out. The main arguments against a regional introduction are the following:

- a. The steering effect is not achieved or only achieved marginally.
- b. The tax revenue is too small.
- c. There are distortions of competition.
- d. Because of the possibilities of evasion, the tax is inefficient.

There is no general answer to these objections since it also depends on the kind of tax, its base, amount, etc. A kerosene tax, for instance, even if it were only raised regionally in Europe, would certainly have a steering effect by providing an incentive for more ecological planes. The European air traffic market is so big that and also lucrative for non-European airlines that the tax would be taken into account. Since foreign airlines also would have to pay the tax when they fly to Europe, all would have to accept the same conditions of competition. There would also be little possibilities to avoid the tax or they would be more expensive than the tax (see also Chapter 3.2.3). If the tax was introduced only in sub-Saharan Africa or only in one country, the steering effect could not be achieved because of the much smaller density of traffic.<sup>28</sup>

The revenue from one tax can be considerable in the case of a regional introduction. Paul Bernd Spahn, professor of public finance at the University of Frankfurt a.M., estimates the amount of revenue from a CTT in the European time-zone at a tax rate of 0.01% on 16-18 billion Euros (see Chapter 3). That would signify a third of the entire development aid from industrialised countries.

Of course it would be desirable to realise an international taxation at a global level. Steering effects and revenue would both be maximised. However, as the examples mentioned above show, a regional introduction could already achieve a considerable effect.

International taxes are not the only case where this problem arises. The Kyoto Protocol is a political approach enforced in climate protection of dealing with a global problem in a multilateral way without all countries taking part. In this case even, the most important actor, the USA as the largest polluter of greenhouse gases, is not participating. Since dealing with

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<sup>28</sup> This does not yet object to a tax since there still would be an income effect.

global warming cannot wait until all states agree to participate, it is better if a partial group starts as a “pioneer group” than nothing happening at all. The case of international taxation is similar. A critical mass would certainly be necessary to achieve a considerable effect. This could generate some dynamics. If the project appears to be successful and its utility visible, others will subsequently join. This procedure would also solve the “free-rider problem”, i.e. the problem of those profiting that are not part of the agreement.

### 3 Currency Transaction Tax (CTT)

The most popular proposal for international taxes is the proposal by the Nobel laureate in economy, James Tobin. The basic idea already goes back to Keynes. The concept and various forms have also been most elaborated.<sup>29</sup> The popularity is also explained by the fact that it is heavily rejected by the financial industry and by conservative politicians. Tobin developed the idea as a reaction to the collapse in the Bretton Woods fixed exchange rate system and its replacement with volatile, market-based exchange rates. He anticipated that the new system would lead to large volatility<sup>30</sup> and instability.

#### 3.1 The Tobin Tax

The core of Tobin's proposal is the following: Currently, about 1.9 trillion (1,900 billion) US\$ are transferred daily between the large financial centres.<sup>31</sup> This business is running 24 hours a day. Less than 3% of the transactions are actually connected to an immediate financing of trade and investment. About 20% are used to secure real economy business against the risk of currency rate fluctuations. The other estimated 80% of foreign exchange trade are of speculative nature. The aim is to exploit differences in currency and interest rates and to speculate on shares and other bond fluctuations. The input of a large amount of money in the range of hundreds of millions already leads to a profit in millions assuming a difference in currency rates of one base point (this corresponds to 0.01%). Such transactions are occurring in their thousands every day, 80% of them in Dollars, Euros, Yen, Pounds and Swiss Franks.

The wholesale trade in currencies is handled by big banks, investment funds, and insurances. Their number is quite small. Most transactions worldwide are carried out by a small number of 25 actors. This has opened a possibility to earn big money that genuinely has its origin in globalisation. Without the liberalisation and deregulation of financial markets, this kind of business would be impossible.

The basic idea of the Tobin Tax applies to the foreign exchange wholesale: Even a small taxation in all foreign exchange transactions would make a large amount of daily transactions unprofitable. They would be stopped. The extent of the reduction would mainly depend on the tax rate level and the anticipated reaction of the market participants (elasticity of demand). At a tax rate of 0.25%, according to experts, the transaction volume would be reduced by at least a third. (Tobin was even thinking of a tax rate of 1% at first). Therefore, the tax basis would shrink. Two thirds of the trade would continue and would continue to yield taxes. We have to consider that the tax is raised during the purchase and sale of a currency, i.e. a single transfer back and forth (round trip) would be taxed with half a percent at a tax rate of 0.25%.

The result: The amount of transactions is reduced and therefore the sum total of daily turnover. The surplus liquidity would be cut down and this would calm down and stabilise the financial markets. The "hot money" that is destructive from a macroeconomic point of view would be discouraged but the international capital flow would not be completely abolished. Tobin himself spoke of throwing a "spanner in the works" but not stopping the works. The tax therefore functions as a filter. For real investment and trade transactions that require a currency exchange, the tax would not have much effect. The short-term transactions within hours or a few days would be reduced.

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<sup>29</sup> See e.g. Jetin (2002), Schmidt (1999) and Wahl/Waldow (2001).

<sup>30</sup> Intensive fluctuation.

<sup>31</sup> April 2004. The number varies.

#### Box 4: How the Tobin Tax works

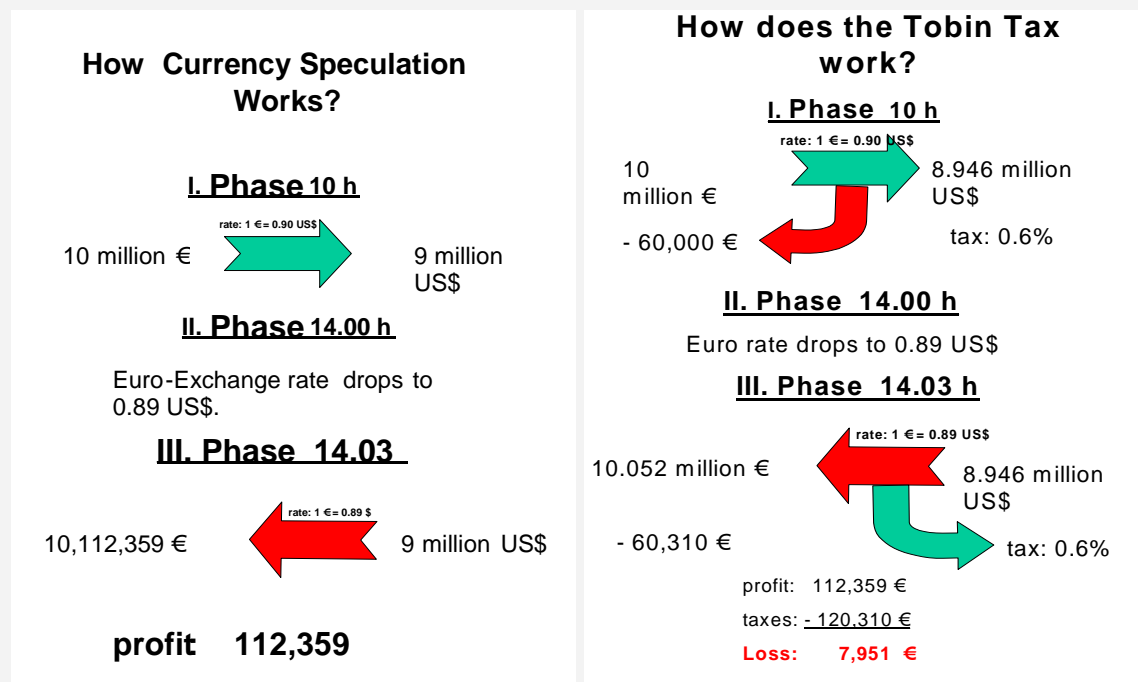
A case study shows the practice of foreign exchange speculation and the effect of the Tobin Tax. The normal procedure of such a speculative transaction is carried out like the following scheme:

**Phase I, 10.00 am.:** Anticipating that the Euro will fall in relation to the Dollar by one Cent in the afternoon, I exchange 10 Million Euro for Dollars in the morning. The rate of Euro to Dollar is currently at 1:0.90. Therefore, I receive 9 Million Dollars for my 10 Million Euros.

**Phase II, 2.00 pm.:** The rate of the Euro declines in the afternoon as expected, by one Cent, i.e. the rate of Euro to Dollar is at 1:0.89.

**Phase III, 2.03 pm.:** I change my 9 Million Dollars that I received in the morning back to Euro. With the new exchange rate, I receive 10,112,359.55 Euro. So I have made a profit of 112,359.55 Euro. This is the gross amount of course, since some small fees and other costs are deducted.

Fig. 3: How the Tobin Tax Fights Currency Speculation



Source: Peter Wahl, WEED

If a tax was imposed on every foreign exchange transaction, then the transaction would look like this:

**Phase I, 10.00 am.:** I exchange my 10 Million Euros to Dollar in the morning. Rate 1:0.90. However, there is a tax imposed now. To explain the logic we will set the tax rate at 0.6% to simplify calculations. This means I pay a Tobin Tax of 60,000 Euro.

**Phase II, 2.00 pm.:** The rate of the Euro again falls by one Cent in the afternoon.

**Phase III, 2.03 pm.:** I exchange my 8.946 Million Dollars back again. However, this transaction also entails a tax of 0.6%. At the new afternoon rate of 1:0.89 this means 60,310 Euro. If I compare my profit with the taxes of 120,674 Euro, I find out that I have made a loss of 7,951 Euro. Since an institutional investor has already made this calculation in advance, there will be no transaction.

For Tobin, the steering function of the tax was most important, i.e. the reduction of speculation. For the utilisation he suggested to put the money into development aid without going into further detail.

In its original version, however, the tax had a weakness: It discourages the everyday, more or less “normal” speculation on currency differences in the range of less than one percent or one-tenth of a percent. As soon as larger fluctuations occur, i.e. in times of crisis, the tax loses its



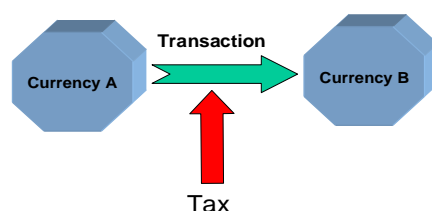
discouraging effect. During the crash in South East Asia in 1997/98, when currencies fell by 40% or in Indonesia even by 60%, just as high profits were possible. This is not an argument against the introduction. There still is a limited steering effect, and achieving tax revenue is a legitimate motive especially in the case of financing development.

Due to the limited steering effect of the classical Tobin Tax during financial crises or speculative attacks, a modification of the tax has won recognition among the proponents (in civil society<sup>32</sup> as well), a two-step model proposed by Paul Bernd Spahn, a finance specialist from the University of Frankfurt.

**Fig. 4: Tobin's Idea of a „spanner in the works“**

#### Tobin's Basic Idea:

- Reduce short-term capital flows
  - Reduce over-liquidity



- „spanner in the works“

### 3.2 The two-tier Currency Transaction Tax (Spahn Model)

In spring 2002, Spahn elaborated his proposal extensively in a survey for the German Ministry for Economic Co-operation and Development. This tax consists of two parts: firstly, the classical Tobin Tax and secondly the actual innovative element, a so-called exchange rate stabilisation duty. Spahn calls it ERND (Exchange Rate Normalization Duty), and it is meant to take effect in cases of crises or prevent them (called anti-crisis tax in the following).

The first step corresponds to the classical Tobin Tax but with a tax rate of one basis point = 0.01%. This appears to be very little at a first glance. However, on the one hand the levy is doubled once a speculation transaction is completed, as soon as the re-exchange is made. Secondly, speculative transactions are carried out again and again and thus taxed and taxed again. If someone speculates with a sum of 10 million US\$, he pays 1000 US\$ in taxes at the first exchange, at the re-exchange the tax amounts to 2000 US\$. If he or she repeats this exchange with the same sum once a day, then this sum is multiplied by 250, i.e. within one year the tax reaches an amount of 500,000 US\$. Related to the capital stock of 10 million this is 5%.

This step of the tax works during normal exchange rate fluctuations. However, if the amplitude of the exchange rates exceeds the usual extent, then the second step automatically

<sup>32</sup> For instance, the "European Network for a Currency Transfer Tax" advocates the two-step model. Members of the network are NGOs, among them WEED from Germany, church relief organisations and the ATTAC-organisations of Belgium, France, Italy, Spain and Sweden.

takes its effect. The speculation profit that exceeds the normal rate is taxed prohibitively high, i.e. the profit is practically taxed away completely. Such transactions would stop straight away and then the exchange rates would decline to their normal height. A speculative attack then makes no sense since practically the entire speculation profit would be siphoned off. The whole story would mean the following:

- Exchange rates would be more stable and the exchange rate risk would be more calculable. Then the costs would decrease for securing exchange rate risks in trade and investment. Therefore, the tax would be “profitable” for the real economy because of its steering effect.
- There would be a strong restriction on speculation profits. This provides incentives for investors to invest more in real economy.
- Speculative attacks would be made impossible.

### 3.2.1 The Extent of the Tax Revenue

As we can see, the steering effect is also the most important issue. However, the revenue resulting from the first step of the tax is also quite considerable. According to Spahn's calculations, even a unilateral introduction in Europe would raise 16 to 18 billion Euro (= 20 to 24 billion US\$ at the current exchange rate)<sup>33</sup>. By including the USA and the large Asian finance centres, the revenue would amount to 60 to 75 billion US\$.

Since the tax rate of one base point is no dogma and 0.015% or 0.02% would also be possible without the markets collapsing, the revenue would increase correspondingly. This reveals an important advantage of the CTT: The tax base is so big that even a small tax rate could generate an incredible amount of income.

The second step would principally not generate any revenue since its aim is deterrence. The “emergency case” would not occur if the speculators would act in line with the market, i.e. would not go into business without any expectations of profit.

### 3.2.2 What is a “Normal“ Exchange Rate?

Well, how is a normal exchange rate determined? Spahn proposes the following procedure: At first, an exchange rate corridor is defined for the relation between two currencies, something like a safety barrier against stronger exchange rate amplitudes downwards and upwards. As in the example of the European currency system of the 1990s, the central banks resp. the governments determine an orientation exchange rate and a deviation upwards or downwards. As long as the exchange rate moves within these safety barriers, the anti-crisis tax is not activated (See Fig. 5).

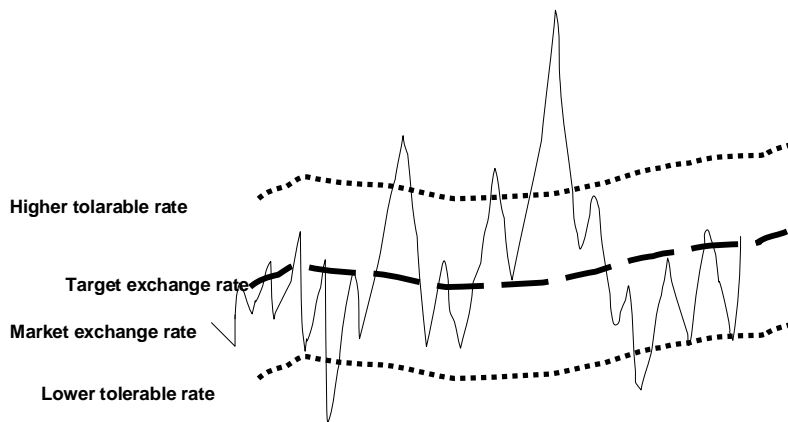
Each pair of exchange rates could have a different corridor. The decision on the target exchange rate is not an arbitrary decision but a continuation of the average exchange rate of the previous four months or a weighted average of the rates during a longer period. Therefore, the target exchange rate can be altered. With such a construction, exchange rates can be continuously integrated into the model and real economy developments are reflected. Abrupt changes in exchange rates, however, would still be outside these safety barriers because of the clearly defined fluctuation margins of the target exchange rate. A sudden strong deviation would lead to the assumption of increased currency speculation. And precisely in this case the anti-crisis tax would be activated.

If the exchange rate alteration would be caused by obvious changes in real economy, then the devaluation pressure would remain. In Spahn's Model, there would be a floating adjustment of the target exchange rate until the real exchange ratio would be approximately reflected.

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<sup>33</sup> Rate as of April 10<sup>th</sup> 2005.

**Fig. 5: Exchange Rate Corridor for a Spahn Tax**



Source: Spahn 2001

### 3.2.3 Unilateral Introduction and Evasion Possibilities

The two-tier currency transaction tax can be introduced unilaterally, i.e. even in one single country so that it can stabilise the exchange rate of its currency and avert speculative attacks. Since the currency of a single country can hardly be used for speculative short term investment because of the smaller money supply, the international financial markets are not affected. At the most, a minor competitive disadvantage could be asserted if a similar country would not introduce the tax. In this case there would be the option of fixing the first tier of the tax at zero. On the other hand, a unilateral introduction of the tax would mean that the country could use the revenue itself. If cleverly applied, the benefit would be much bigger than the disadvantage of the tax. Especially the small economies that are extremely dependent on the global economic framework would receive an additional instrument they could implement autonomously and according to their own needs.

The question could be more complicated for the main currency countries since the daily speculation business is carried out in their currencies. Therefore, an often raised objection is that the introduction of a CTT would lead to evasion and avoidance manoeuvres and thus to a competition disadvantage of the finance industry in concern.<sup>34</sup> Studying the structure and dynamics of the global financial flows more closely, we can see that evading and avoiding the CTT would be much more expensive than paying the tax. For, as mentioned before, capital input into the financial markets is happening 24 hours a day, successively and electronically linked together in the three time-zones America, Far East and Europe. If a tax were imposed in one of the time-zones, then tax evasion would mean in this case that the transaction could not occur. The lost profits would be more severe than the tax.

Even the theoretical possibility that the working day would be doubled elsewhere to compensate the loss of one time-zone, i.e. an early and a late shift would be introduced to

<sup>34</sup> The legitimate question as to what would be so bad from a macroeconomic point of view is not dealt with here. The access to liquidity would definitely not be affected, since the technical equipment of the sector delinks it from a location.

continue the trade, would be possible due to electronic communication possibilities but would create costs that would be unreasonable in comparison to the burden of the CTT. Other methods of evasion like switching to derivative would cause costs that would be higher than the tax.<sup>35</sup>

Additionally, the number of actors in currency wholesale is relatively small – between 20 and 30 institutes. Such a small number of tax payers makes control very easy. For all these reasons we can surely assume that a unilateral introduction of a CTT would not lead to deflection effects.

### **3.2.4 Imposition**

Just like the cashless transactions across national payment systems are mostly processed electronically, there have been such systems for international payment transactions for some time. Since banks and trade have a great interest in a secure process of their transactions, these systems are very secure. The most important are the European TARGET System (Trans-European Automated Real-time Gross Settlement Express Transfer System), the US Fed Wire and the British CHAPS (Clearing House Automated Payment System). These systems are practically used by all actors on the financial market.

The so-called S.W.I.F.T. System (Society for Worldwide Interbank Financial Telecommunication) was established years ago. This private network provides central banks with information on the process of financial transactions carried out by the finance market participants through SWIFT. Meanwhile, development has continued. Since 2002, the CLS Bank (Continuous Linked Settlement Bank) is functioning. The CLS is a corporation supported by 80 big banks world wide with the task of concentrating foreign exchange dealings even more and to accelerate the processes.

By including the adequate software into these payment systems, the tax could be imposed fully automatically and with minimal costs. Therefore the often raised objection that an imposition of the CTT would entail a bureaucratic effort and were difficult to carry out is meaningless. The tax is technically as easy as the automatic direct debit of account management charges on private accounts.

### **3.2.5 Distributive Effect and Acceptance**

From a distribution policy point of view, the CTT is practically ideal. It affects the customers of currency dealers, a relatively small group of economically powerful actors who invest their capital in speculative transactions. Unlike mass taxes, the CTT collects the money where it is available in abundance. The CTT is an example where one of the basic aims of international taxation that the winners of globalisation should yield some of their profits is especially evident. Therefore, an important requirement for public acceptance and political enforcement is provided.

The possibility of introducing the tax unilaterally within the European time-zone is also quite attractive, as it does not lead to evasion and avoidance. However, European time-zone means that the finance centres of the Euro zone, London and preferably Zurich need to be included. Especially without London the most important financial centre worldwide, the regional introduction would be ineffective since the evasion possibilities to London would be so cheap that a deflection would be profitable.

In the Euro zone, the prospective for a CTT is clearly more favourable. The number of proponents is increasing all the time. Among them are Economic Nobel Prize Laureate Stiglitz, the former big speculator George Soros who knows from an insider's perspective what he's talking about, the French National Assembly, the Belgian parliament and the

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<sup>35</sup> This is explained in detail in Kapoor (2004).

French President Chirac. In his speech in Davos, the German Chancellor Schröder considered CTT, and the Development Minister is a proponent of CTT in the Federal Cabinet. The state council of the Green Party that included the CTT in their Party Programme, decided on April 3<sup>rd</sup>, to start a parliamentary initiative for the CTT. And for quite some time, trade unions, development NGOs and charity organisations like Misereor are proponents of the CTT.

Considering the importance of London as a financial centre, the British position on CTT is of decisive importance. The British government has not advocated a CTT yet but also has not rejected it. Under the headline: *"What is our position on proposals like Special Drawing Rights and Tobin Tax"*, the latest paper on IFF in September 2004 says: *"The United Kingdom will continue to examine a variety of different options for acquiring funds like Special Drawing Rights and other earnings at a world-wide level. These have the potential to mobilise significantly larger resources for development on a long-term basis, even though further analyses have to be made on the technical feasibility. We appreciate the efforts to find long term solutions but there also is an urgent necessity for short term and medium term means."*

On the one hand, CTT are not completely rejected, on the other hand, the vague indication that further investigation is necessary also sounds like postponement considering the very extensive expertise that is available.<sup>36</sup> The insufficient political acceptance in the EU is currently the only obstacle to an implementation of a CTT. However, the experience of the past ten years does show that a shift in power relations is possible. Considering the enormous influence of the finance industry on governments, the objections against CTT and the threats of dislocation will still continue. Once the CTT has been introduced, it will be paid – even if grudgingly.

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<sup>36</sup> IFF (2004): p. 24.

## 4 Environmental Taxes

Environmental taxes have been playing a role in the discussion of innovative financing instruments for quite some time. At the first international Environment Conference, 1972 in Stockholm, global taxes were already suggested. At the same time, the Club of Rome was discussing international taxation to finance international organisations in the legendary report "Limits to Growth". In 1987, the UN Environment Programme published a survey that suggested international taxation to finance measures against desertification.<sup>37</sup> The logic of international taxation is easily comprehensible concerning environmental taxes:

- Many environmental problems are as a matter of fact of international or global nature and cannot be dealt with on the national level alone. This applies to global warming due to anthropogenic emissions like CO<sub>2</sub>, sea pollution or the loss of biological diversity. Therefore, an international financing mechanism is also obvious.
- From an economic point of view, environmental damages are negative externalities. They cause costs that the consumers do not pay for. A tax or fee would internalise these costs, and the polluters would – at least partially – pay the costs.
- Many environmental goods are global public goods. They should also be financed publicly, i.e. through taxes.

### 4.1 CO<sub>2</sub> Tax

One of the oldest proposals and at the same time one of the most popular environmental tax proposals is the CO<sub>2</sub> Tax. Its main aim is the steering effect, i.e. the reduction of the most important greenhouse gas. Under the pressure of climate change, the CO<sub>2</sub> Tax seems to have a good chance of realisation up until the mid-Nineties. With the Kyoto Protocol, however, the concept of tradeable pollution rights was enforced. Its function, last but not least, was to stop a CO<sub>2</sub> Tax. This is why the past few years have been very silent as far as this tax is concerned. Now that the Kyoto Protocol has come into effect on February 16<sup>th</sup> 2005, the situation could change. On the one hand it is clear that the reduction goals of the Kyoto Protocol<sup>38</sup>, even if they were met, would by far not be sufficient to prevent a climate catastrophe. On the other hand it is unclear what a climate protection strategy should look like in the next years. Kyoto has strained the negotiation capacities to such an extent that a real strategic vacancy has emerged. Possibly this would be a good opportunity to advance into the gap with a CO<sub>2</sub> Tax, amongst others. From an environmental perspective the tax would be very useful:

- CO<sub>2</sub> is the main cause of the greenhouse effect.
- CO<sub>2</sub> is caused by many different sources, for instance transport, fire heating, electricity production, so there is a large and broad tax base.
- The steering effect is also broadly dispersed.
- The greenhouse effect is a global problem that cannot be solved on a national level.
- The tax revenue would even be relatively high with a low tax rate (that would also have a smaller steering effect). The Landau Report assumes that a tax of 100 US\$ per ton of coal equivalent would raise 100 billion US\$.

However, the CO<sub>2</sub> Tax would not be so ideal from a distributive perspective, especially in the North-South relation, as it benefits those countries that have the means to reduce emissions with high-tech and therefore reduce the tax. Usually, these are the industrialised countries. An international agreement would have to include mechanisms for compensation that would make the whole agreement quite complex. Even within the industrialised countries, the tax

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<sup>37</sup> UNEP (1978).

<sup>38</sup> The Kyoto Protocol requires that industrialised countries should reduce their CO<sub>2</sub> emissions by 5% until 2012.

would have negative distributive effects. Since corporations emitting CO<sub>2</sub> could pass on the tax to their customers, the tax burden would be on the individual consumer, and therefore would be regressive like a mass tax. Given these problems, a strong political pressure would be necessary to reach an appropriate agreement.

## 4.2 Taxation of Air Traffic and User Fees

In contrast, it is likely that a taxation of air traffic is going to be put on the environmental agenda soon by some European governments, among them France and Germany. The Kyoto Protocol explicitly excludes aviation. Therefore, corresponding measures could be an ideal amendment to Kyoto.

This is all the more obvious considering the fact that the environmental problems caused by air traffic are quite serious, especially:

- The use of kerosene due to the increase in traffic despite large aircraft and modern engines.
- Damaging emissions in the vicinity of airports.
- Noise emissions in the vicinity of airports.
- Depletion of the ozone layer by flying in high altitudes.

The Landau Report estimates that the environmental damages caused within the EU amount to 32 billion Euros a year.<sup>39</sup> Additionally, there are indirect effects, like the consequences of mass and long-distance tourism that is stimulated by the cheap prices. Since 1960, air traffic has annually increased by 8% and has become an important driving force of globalisation. Different approaches are being discussed towards an international tax on air traffic. The three most important are the following:

- The taxation of kerosene.
- The taxation of air plane tickets.
- Fees for the utilisation of air corridors.

### 4.2.1 Kerosene Tax

The arguments for taxation on kerosene are:

- It is a scarce non-renewable resource.
- Its combustion directly contributes to the greenhouse effect, i.e. causes immediate environmental damage.
- Due to the preceding tax freedom, an unjustified distortion of competition in relation to other transport systems has emerged and environmentally more friendly systems like trains are disadvantaged.<sup>40</sup>
- A tax would lead to a steering effect since there is an incentive to use engines that consume less and reduce emissions.

The tax would be raised at its source, i.e. where the kerosene is tanked. The EU could impose this tax unilaterally. Considering the large amount of traffic, the steering effect would still be enormous.

A distortion of competition would not arise since airlines from other countries would have to pay as well as soon as they use fuel. Possibilities of avoiding the tax are not excluded but due

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<sup>39</sup> Landau (2004): p. 83.

<sup>40</sup> The German railway, *Deutsche Bahn*, has filed a lawsuit at the European Court of Justice.

to technical constraints a kind of fuelling tourism – American Airways quickly flies a detour to Kiev for a tank stop on its way to Frankfurt – is likely to be more expensive than the tax.

The revenue of the tax, if introduced globally at a tax rate of 20%, would amount to 10 billion US\$ according to the Landau Report.<sup>41</sup> Converted to the individual ticket, this would be an increase by 2.5%, i.e. very little. From a distribution policy perspective, the tax would be slightly regressive. Since mostly mass tourism would be affected, it would not really be a serious social problem. However, the revenue would not be high enough to finance the MDGs, even with a higher tax rate. This is no fundamental objection. The tax could only be an instrument among others if it is meant to contribute to financing MDGs.

Additionally, there is a serious legal problem: The air traffic lobby has succeeded in including tax freedom for kerosene into the bilateral air traffic agreements that need to be made between all countries that maintain air connections between each other. A change of law could only be achieved multilaterally through IATA. This clearly diminishes the political chances of a kerosene tax.

#### **4.2.2 Taxation on Air plane Tickets**

The legal problems of the kerosene tax do not arise with the direct taxation of air plane tickets. Additionally, there would be an option of introducing a distributive policy component to increase its acceptance. The tax rates for First and Business Class could be higher than the Economy Class rates. This is also a good idea because the proportion of these tickets in the airlines' turnover usually equals two thirds and would therefore be a high proportion of the revenue. If a tax rate of 5% on First and Second Class tickets were introduced globally, the Landau Report calculates a revenue of 8 billion US\$.<sup>42</sup> However, the steering effect of the tax would be small. There would only be an effect if there were fewer flights. This cannot be expected with passengers of the First and Business Class.

A unilateral introduction is possible. However, there would be cheap evasion possibilities. Big travel agencies and maybe even the airlines themselves would sell tax-free tickets through other countries and send them to the customers electronically or by post. The amount of prepaid tickets issued in tax-free countries would also increase drastically.

#### **4.2.3 Fees for the Use of Air Corridors**

Civil air traffic is guided through fixed air corridors, practically like streets in the air. Therefore, taxation would follow the same logic as a motorway toll or street fee. The huge advantage of such a fee would be that it is being raised already, i.e. the mechanisms for its imposition are already established. The fees could be introduced as an additional charge without any problem. The imposition is carried out automatically via computers.

To achieve an ecological steering effect, there would have to be a differentiation according to aircraft type. More would have to be paid for technically old machines than for aircraft with optimised consumption and emissions. The height of the charge could be seen as an equivalent to the direct kerosene tax. Therefore, the revenue would be within the same range but could be designed in different ways. The German "Scientific Council for Global Environmental Changes" (WBGU) has estimated in a 2002 survey that the possible income could amount to 30 billion Euro.

This fee could also be introduced unilaterally. The possibilities of evasion are negligible. The deviation of destinations to tax-free countries would be too costly in time and money for the passengers that it would not be worth it. The same would apply to evasion flights for pure transit traffic. For all these reasons, this fee could be one of the aspirants for a fast realisation.

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<sup>41</sup> Landau (2004): p. 84.

<sup>42</sup> Landau (2004): p. 84.



### 4.3 Taxation of Maritime Shipping

Like air traffic, maritime shipping traffic has increased by an incredible amount due to globalisation. 80% of the global goods are transported by sea shipping. From 2005 until 2010, an increase by 5% a year is expected.<sup>43</sup> The shipping trade is also amongst the winners of globalisation. A tax on their earnings would just be logical. Three options are currently being discussed. A taxation on emissions, transports of dangerous goods (oil, chemicals, nuclear waste, toxic waste, etc.) and on shipping routes.

#### 4.3.1 Fees on Emissions and Transports of Dangerous Goods

Since 1990, 1.1 billion tons of oil were spilt into the sea, sometimes by oil-tankers, sometimes by illegal ocean dumping. Serious environmental risks also emerge through the transport of chemicals. Since 1965, 10,000 accidents during transports of oil and dangerous goods were registered.<sup>44</sup> Spectacular catastrophes like the Exxon Valdez accident have led to an increased awareness in public opinion. Therefore, the acceptance of a tax is likely to be very high.

Moreover, an institutional precondition already exists as a starting point. The "International Oil Pollution Compensation Fund" (IOPC), a fund to cover damages through oil-tanker accidents, established in 1971 and extended in 1992. Since the costs of tanker accidents often exceed the individual liability capacities of the polluters, the fund steps in to cover the damage. Legally, the IOPC is an intergovernmental organisation, with 93 member states (the USA are not a member). The fund is financed by fees paid by the customers of oil transports, e.g. refineries. States do not pay into the fund.<sup>45</sup> Additional finances could be generated if there was an extra charge on the existing fee without any additional effort for the imposition.

Of course there resources could flow into financing MDGs. In this case it would be even more logical if they would flow into an improved regulation of damage or preventive measures against oil spills. Since the fund works like an insurance and only gets active as soon as an accident has occurred, there is no steering effect.

Marine goods transport has also become a non-negligible polluter of CO<sub>2</sub> emissions. Sulphurous exhaust fumes near the coast cause pollution ("acid rain"). Just like air traffic, this is not included in the Kyoto Protocol. Taxation on fuel would provide an incentive to modernize ship motors. The Landau Report estimates that a tax rate of 10% would lead to a revenue of 1 billion US\$ worldwide. This sum is not very attractive on the one hand, on the other hand the negative environmental effects are only insufficiently internalised. To achieve this aim, a tax rate as high as 150% of the fuel costs would be necessary. The worldwide revenue would then amount to 20 billion US\$.<sup>46</sup>

This seemingly drastic tax rate is not an obstacle against its introduction. However, it would be necessary to ensure that air traffic is also taxed more heavily at the same time so that there is not a shift of freight from sea to air. This would be unacceptable since maritime transport basically still pollutes the environment much less than air traffic.

The imposition of the tax could relatively easily be carried out at the destination ports. Several fees are already collected when unloading cargo, for instance for the use of port infrastructure. At the same time, an evasion of the tax would be more or less impossible. It probably would be very difficult these days to unload goods outside a port and thus beyond the control of the authorities. Relocation strategies are also unlikely, for instance if alternative ways of transport on roads, railways or inland waterways exist that are cheaper than the tax.

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<sup>43</sup> Landau (2004): p. 85.

<sup>44</sup> Landau (2004): p. 85.

<sup>45</sup> [www.iopcfund.org](http://www.iopcfund.org).

<sup>46</sup> Landau (2004): p. 86.

The main burden of the tax would be on trade. This means that the tax could be passed on to the prices and therefore passed on to the customers. This still does not speak against the tax. For it would be precisely this consequence that would lead to ecologically desirable substitution effects, for instance if regional or local agricultural products are more competitive. This could lead to economic winners in organic farming.

Due to the possibilities of shifting the burden onto the customers, the exports of developing countries would not be affected, however, their imports would be affected. The distributive effect in the South would be mainly progressive, i.e. mainly the upper and middle classes would be affected. On average, low-income classes are less able to consume imported goods, and the competitiveness of local producers would be strengthened as well – a positive steering effect in development and social policy.

A problem could arise due to the increased trend towards ships with flags of convenience. The legal shift of a ship's country of origin to a flag of convenience country (the most well-known are Liberia and Panama) lets the ship-owners reduce freight costs by wage dumping and avoiding social and security standards. The conditions in shipping trade are like Manchester capitalism, with detrimental effects on security and environment. This is a classical case of "*race to the bottom*" with a strong tailwind due to globalisation.

It would be logical to introduce a two-tier tax rate and impose higher taxes on flags of convenience. Just like the OECD and IMF have blacklisted tax havens, a black list of flags of convenience would be necessary. This would solve two problems at once. In relation to competition, because the flag of convenience ships distort international competition, and the compliance with social standards would be improved as well as shipping traffic security. The additional funds could serve to fight poverty in Panama, Liberia, and elsewhere. Therefore, the objection that the flag of convenience countries, usually developing countries, would be disadvantaged is obsolete.<sup>47</sup>

Finally, this kind of tax is among those that could unilaterally be introduced in the EU. Since the EU is the biggest trading power of the world, revenue and steering effect would still be quite considerable.

#### **4.3.2 Utilisation Fee on Sea Straits**

Sea straits are a pure global public good. The characteristics of the public good have been developed and are secure in international law, i.e. the freedom of the seas cannot even be curtailed by abutting states. Everybody can use this good, its use does not limit others. Unfortunately, the latter only exists in principle. Due to the increase in shipping traffic, there are regularly traffic jams at the most frequently used sea straits.<sup>48</sup> At the same time, there is a danger of collision and their possible damaging effects such as environmental pollution by oil tankers and other transports of dangerous goods. This is the approach for imposing a levy on the use of sea straits. The logic is the same as with motorway tolls or a toll on bridges, tunnels and mountain passes.

There are practically no possibilities of evasion, unless the fee would be so high that it would be profitable to make a detour around the sea strait. The imposition is also quite easy, since the technical possibilities exist to register ocean passages sufficiently and cost-efficiently, e.g. through the Global Positioning System (GPS) via satellite. The distributive effect would be similar to the taxation of ship emissions and transports of dangerous goods (see above).

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<sup>47</sup> A this point we shall not examine how this would be treated at the WTO, within the conflict between the non-discrimination clause and anti-dumping rules.

<sup>48</sup> The Channel is at the top of the list with 225 ship movements a days, followed by the Strait of Malacca (200 per day).

Again the question will arise if it would not be sensible that the revenue goes to the abutting states to compensate the costs resulting from control and damages in their territorial waters or on their territory – especially in the case of developing countries.

As far as the revenue of such a tax is concerned, the Landau Report also suggests a fee of 13,000 US\$ on average per passage.<sup>49</sup> This amount is based on the following calculation: If a ship would not cross the Channel but sail around Scotland, this would lead to an average cost of 40,000 US\$ due to increased operational costs and the time-consuming detour. A third of this would be the fee of 13,000 US \$. This sum appears to be high at first but it has to be compared with the economic dimensions of ship cargo. An example: The value of a cargo of a tanker with 100,000 gross registered tons – this is the equivalent of a small ship these days – is usually in the range of 5 to 8 million US \$. The passage fee would then equal about 0.2%.

The third, of course, is an arbitrary definition. The tax rate could be increased or decreased depending on how far the specific interests are able to prevail in the negotiation process. An increase would certainly have to be applied carefully since there should be no economic incentive for a detour around Scotland. This would entail further ecological pollution. As a result, 1.1 billion US \$ would be raised per year. When the other densely sailed sea straits in Asia were included then the yield would amount to 3.6 billion US \$.<sup>50</sup> These are of course relatively small sums, if they are compared with the potential of a Currency Transfer Tax.

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<sup>49</sup> The Channel traffic to England would of course be excluded.

<sup>50</sup> Landau (2004): p. 89.

## 5 Other Innovative Taxes

The concepts of the CTT and of international environmental taxes, especially the taxation on air traffic, are the most extensive and currently have the biggest chances of being implemented. Furthermore, there are a few other interesting proposals that are presented in a summarised overview below.

### 5.1 Taxation of Transnational Corporations

Transnational Corporations (TNCs) are among the winners of globalisation. Their number has increased drastically. In 1990, there were 37,000 TNCs with 175,000 branches, and in 2003 they already amounted to 64,000 with 870,000 branches. The annual turnover of 51 TNCs is higher than the GNP of 130 countries. In other words, among the 100 biggest economic actors there are 51 TNCs and 49 countries. Liberalisation, deregulation and the quantum leap in communications have accelerated and eased the following for TNCs:

- Opening of new markets.
- Cheaper access to capital markets.
- Access to sources of surplus profit at financial markets.
- Cheaper access to suppliers and resources.
- Access to cheaper and more qualified labour force.
- Prevention of taxes and fees through transfer prices and the use of tax havens.

Therefore, absorbing a part of the globalisation gains of TNCs is logical. The theme was practically neglected and strongly eclipsed in the Nineties. One of the signs was the closure of the UN Centre on TNCs in 1992 and the disappearance of the topic in the academic debate. Due to the neo-liberal hegemony, interfering with TNCs was practically declared forbidden. The Landau Report now has quite matter-of-factly raised the topic as a possible option. The IMF and World Bank paper mentioned above also lists the tax in its ranking, even if it sees little chances of political realisation. The advantages of a taxation of TNC profits would be the following:

- A large tax base. Currently, 860 billion US\$ in taxes are raised from TNCs.<sup>51</sup> A general increase by only 5% would already generate a revenue of 43 billion US\$.
- Easy imposition. Taxes for TNCs already exist, i.e. imposing and reallocating the additional amount into development financing would be technically easy and imply very little costs.
- A large amount of allocation justice.
- A compensation, at least partially and indirectly, for the erosion of the national tax base by the TNC's strategies of "tax optimisation".

Among the problematic aspects are the following:

- A regional introduction is difficult since this would result in competitive disadvantages for the affected corporations.
- The earnings could vary quite strongly according to the economic situation. The political resistance is tremendous against such a tax due to the strong influence of TNCs and their lobbies on politicians and the media.

Despite these problems, civil society should advance this discussion by all means. The role and influence of TNCs is one the most important determining factors in the globalisation

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<sup>51</sup> Landau (2004): p. 93.

process. Alternative concepts for a socially just and ecologically sustainable globalisation cannot avoid regulating TNCs, including taxation.

## 5.2 Taxation of the Banking Secret and Offshore Centres

Offshore Financial Centres (OFCs), tax havens and tax dumping are the source of considerable tax losses of the nation states. Developing countries are especially affected by tax evasion. They lose yields in the range of about 50 billion US\$ a year.<sup>52</sup> OFC does not necessarily mean an island in the Caribbean. Even in Europe there are procedures that are typical for OFCs. Austria, for instance, specifically advertises its strict banking secret among capital owners abroad.

As the Landau Report remarks aptly under the heading *Banking transparency as a public good*: "The banking secret strictly corresponds to the definition of what economic theory calls a negative externality. Exerting of a right considered legitimate by one country leads to collateral damage for others."<sup>53</sup>

Attempts of a combined task force by the OECD and the Financial Stability Forum (FSF) to control the tax havens and close loopholes, are half-hearted and weak. Therefore, the suggestion of the Landau Report to generally tax all financial flows to countries with banking secrets and OFCs is sensible.

## 5.3 Taxing International Arms Trade

A proposal for taxing arms trade can already be found in the "Brandt Report". The report of the Lula Group also mentions it. The Brazilian President strongly supported the proposal. The idea has a high moral prestige. The thought of reducing armament this way – this would be the steering effect of the tax – and contribute to peace appears to be very attractive in public opinion.

An exact analysis shows, however, that this expectation cannot be achieved with international taxation. A short glance at the most important indicators already leads to disillusion. The military expense worldwide amounted to a total of 956 billion US\$ in 2003. Meanwhile, mainly because of the costs of the Iraq war, they have exceeded the trillion. The USA spends 446,320 million US\$ of this amount, about half of it. The proportion of international arms trade amounts to about 50 billion US\$, and 10 billion US\$ of this sum is spent on trade in small weapons.<sup>54</sup>

A proportion of 5% of arms trade exports in relation to the entire defence expenditure shows that a steering effect towards peace and disarmament would be very limited due to the quantitative relations alone. Additionally, a tax of for example 10%, as the Landau Report suggests, would have no steering effect. Considering the important role the military still plays in the politics of most nation states, even a tax rate of 100% would have no deterring effect. All large arms exporters would have to join in, among them China and Israel. If not, a "competition distortion" would arise and the rivals would soon grasp their share of the market. Anyhow, there is a large network for illegal arms trade in small and large weapons that offers many possibilities for evasion. The profits in this business are high and black marketing and smuggling is a daily affair.

Then there is the tax revenue. Despite the fact that this only becomes interesting starting with a rate in the range of 20%, the question is who will finally pay if a government not only buys the weapons but also an additional tax. The moral pretension of a tax on arms trade is caught

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<sup>52</sup> Giegold (2003): p. 45.

<sup>53</sup> Landau (2004): p. 96.

<sup>54</sup> SIPRI (2004).

up in moral contradictions. Disarmament and abolishing arms trade are good aims but taxes are not a good instrument to achieve them. Other methods like détente policy, civil conflict management and political co-operation are more likely to succeed.

## 5.4 Further Ideas for Taxation

A large variety of further innovative proposals for international taxation are being discussed, mostly still in the phase of ideas, combined with rough estimates. This does not dismiss these ideas. They should be developed further and kept in the discussion. Especially the proposals with progressive distributive effects are interesting from an emancipatory point of view. If we think beyond the MDGs, then massive amounts of funds are still necessary for ecological transformation and the solution of the social question on a global level. Therefore, thinking about further sources of financing is inevitable.

Among these proposals are the following:

- A tax on the *trade in shares and/or bonds*. Equity trading has a daily volume of 210 billion US\$. The Landau Report estimates the daily turnover in bonds at 840 billion US\$. Therefore, we are dealing with a very strong tax base. Even with a very small tax rate of half a base point (0,005%) there would be revenue of 42 million US\$ per day. Calculated per year, this would amount to 10.5 billion US\$. It is important to note that the tax would not be on the emission but the secondary trade. The primary financing function would not be impaired, unlike the speculative secondary trade. This would be an instrument to fight one of the worst evils of neo-liberal globalisation, the orientation on the *shareholder value*.<sup>55</sup>
- *Portfolio investment* is mostly short-term investments. Most of them are speculative. They are a main cause of the volatility and instability of financial markets. As long as they are lucrative, they absorb capital that could otherwise flow into real investment to create jobs. This tax would have a strong steering effect. Jacques Cossart, fiscal expert of the scientific council of ATTAC France, estimates the revenue at a tax rate of 25% on earnings at 190 billion US\$. This includes the fact that the tax base would shrink by a third due to the steering effect.<sup>56</sup> This is of course a strong intervention that could only be realised on condition of adequate political power relations.
- *Foreign Direct Investment*. The amount of Foreign Direct Investment (FDI) during the last five years added up to an average of 800 billion US\$ per year. A tax rate of 10% would lead to an income as high as 120 bn US\$. However, the interaction with portfolio investment would have to be considered. There must be no incentives that would lead to a further loss in attractiveness of FDI in relation to portfolio investment. In a differentiated form, a tax on FDI could achieve interesting steering effects. For instance, certain locations and/or certain sectors could be taxed less than others. This would provide incentives to invest in countries that have not profited from FDI so far. Similarly, ecologically desired effects and progress in development policy could be achieved.
- *E-commerce*. Electronic trade through the internet is a business that profits from globalisation in a very typical way. There are enormous growth rates.<sup>57</sup> E-Commerce is very lucrative, last but not least because transaction costs are very

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<sup>55</sup> Previously, the profit interest was directed towards the dividend when purchasing shares, and the dividend was distributed once a year. Now the purchase focusses on short-term resale. Speculation yields more profits than dividends. This leads to job loss to keep share values high, i.e. the profitability of shares is increased in the interest of the *shareholders*.

<sup>56</sup> Cossart (2004).

<sup>57</sup> Cf. WTO (1998): Electronic Commerce and the Role of the WTO. Special Studies 2, Genf.

low due to technical possibilities. A tax of 1 Cent on 1,000 Kbytes would raise an estimated 70 billion US\$, based on the level in 2003.<sup>58</sup>

- *Luxury Tax.* An explicit distributive effect is connected to the proposal of taxation of the international trade in luxury goods like sailing yachts, private jets, luxury cars, expensive lifestyle products (e.g. Rolex), as well as expensive spirits, champagne, etc. There would hardly be a steering effect due to the elasticity of demand, i.e. since the purchasers of these goods do not need to care about money, the tax base would be very stable.
- *Taxation on the outer space close to the Earth.* The perigee outer space is considered a global public good. There are an increasing number of commercial satellites on geostationary orbits. The *International Telecommunication Union* (ITU), a UN sub-organisation already issues licenses. This happens on the grounds of "first come, first served". Until 2001, this did not cost anything. Since then, an administrative fee is charged. The licensee can extend the license unilaterally. This results in an overbooking of licenses. This leads to a competition disadvantage for newcomers. An adequate taxation could be realised without much effort.
- *Taxation of the electromagnetic spectrum.* The electromagnetic spectrum falls into the same category. It is administrated in the same way as the Earth's orbit by the ITU.

## 5.5 The International Finance Facility (IFF)

Actually, the IFF has nothing to do with international taxation. However, the concept is often mentioned in connection with financing MDGs as one of the most probable candidates for implementation. One of the reasons is that many link it to the political-tactical strategy of averting the demand for international taxes.

The main idea of the IFF is to disconnect the timing of financing of MDGs from the resource flows of development budgets, to mobilise a part of the future development aid now already. The fast availability is also one of the reasons why some NGOs like the idea. In practice, the IFF is meant to function in the following way:

- The funds – planned are 50 billion US\$ a year – are raised on private capital markets by state bonds of donor countries, i.e. in the same way as the World Bank and the IMF mobilise development funds;
- The project takes advantage of the fact that:
  - a. the donor countries enjoy a more favourable credit rating (like AAA = triple A) as state debtors on the capital markets.
  - b. If they invest the borrowed money in the recipient countries, they can achieve high profits. The difference finances a part of the IFF. The British Exchequer explicitly refers to the experiences of the World Bank, their programme and project investment yields 23% in profits on average;<sup>59</sup>
- The repayment of the bonds is extended over 30 years. Just like the interest rates, the repayment would have to be exclusively financed by the donor countries from their state budget.
- The recipient countries receive the funds as a donation or as debt relief.
- The IFF is a financing mechanism and no institution. The mechanism would be managed and conducted by the existing bilateral and multilateral development institutions. Its duration would be limited.

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<sup>58</sup> Cossart (2004).

<sup>59</sup> IFF (2004): p. 14.

- The 50 billion US \$ could be raised even if not all OECD countries are involved.<sup>60</sup>

However, this instrument has some severe disadvantages. The Landau Report correctly points out that the duration of 30 years postpones repayment of the loans to future generations.<sup>61</sup> Since the realisation of the planned profits is not actually certain, a large amount of the ODA could be absorbed after 2015.<sup>62</sup> Following the logic of the MDGs, according to which 50% of the absolutely poor will still be poor after 2015, this would be a disturbing risk.

The British NGO *World Development Movement* estimates that the IFF actually only mobilises 19 billion US\$ a year.<sup>63</sup> Furthermore, the aid is apparently bound to conditionalities. Not included in the proposal, the Chancellor of the Exchequer, Brown, explained in May 2004 that the "countries only receive the proposed development aid" if they show that they can deal with problems "in connection with fiscal and monetary stability and open up to trade and investment."<sup>64</sup>

Finally, there is a very basic objection: The IFF functions according to the current logic of the financial markets. This includes the distributive mechanisms that lead to permanent resource flow from South to North because of the indebtedness of developing countries, exchange rate volatility, and currency hierarchies as well as financial and currency crises.<sup>65</sup> It is difficult to quantify this but in any case, the profits gained on the international markets are linked to corresponding losses. For instance, if a part of the attractiveness of the IFF is due to the fact that the donors receive the best conditions on the capital market, then the private investors compensate this through the low degree of creditworthiness of many developing countries that indirectly co-finance the IFF with their much more unfavourable conditions. This reveals the ambivalence of those NGOs that support the project because of the fast money promised by the IFF. The moral dilemma is easily understood. The prospect of being able to save human lives with a quick flow of funds, e.g. for fighting Aids, is a quite respectable motive.

All this does show that even if the IFF were decided, international taxation would not be superfluous. On the contrary, the flaws of the IFF can act as starting points to argue for the necessity of international taxation.

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<sup>60</sup> The USA have already indicated that they are not willing to support the project.

<sup>61</sup> Actually, the argument on the future generations is used in neo-liberal discourse. It is ideological since it only sees debtors in future generations. Each Cent of debt, however, is accompanied by an equal amount of wealth of a future creditor. Adequate mechanisms of redistribution, for instance taxes on capital income, would reduce the future debt burden.

<sup>62</sup> Landau (2004): p. 44.

<sup>63</sup> WDM (2005): p. 5.

<sup>64</sup> Cited after WDM (2004): p. 7.

<sup>65</sup> Cf. Fournier et al. (2003).



## **6 A New Dynamic? – The Political Conditions for Achieving International Taxation**

In view of the secular failure of efforts up to now concerning development financing, the question now is whether international taxation has a better chance of being achieved than was previously the case. We can only speculate about the answers. However, the prevailing conditions for development financing can be examined to discover if these have changed compared with previous conditions. The elements of such an analysis will be presented below.

A concentration in discussions on innovative financing instruments that cannot be ignored has occurred, including about international taxation. The demands for such instruments no longer only come from civil society, critical economists and leftist politicians. A new quality is exhibited by the fact that:

- The Belgian Parliament has for the first time formulated a law for a currency transaction tax (CTT).
- Chirac and Zapatero, two country leaders of important industrialised countries have for the first time become active for an international tax and are considering unilateral action.
- An increasing number of studies, partly commissioned by states or international organisations, confirm the feasibility and desirability of international taxation and so contribute to increasing the political pressure.
- Even the IMF and the World Bank can no longer distance themselves from the subject. At the Spring meeting of 2005, the subject was on the day's agenda and an internal paper by its members can definitely conceive of an international taxation

### **6.1 The Belgian CTT Law**

In 2004, the Belgian parliament passed a law on the taxation of international currency transactions (see extract in box 5). Thus, the CTT has for the first time been made operational and therefore goes past the stage of political demand to which the decision of the French National Assembly was limited. This law therefore clarifies many of the questions of practical feasibility and has shown many technical objections of the critics to be baseless.

The taxation concept on which the law is based is the two-stage variant of the Tobin tax as proposed by Spahn (see extensive details in Chapter 4,2). The tax revenue should flow into a European fund for financing development. The implementation does indeed require that other European states join the initiative. But in contrast to the French National Assembly resolution, which at the time only basically favoured such a tax, the Belgian project is actually formulated down to the details of technical implementation. In this way, many objections to the currency transfer tax, CTT, are removed. The Belgian parliament has commissioned its government to win support for the tax among other EU countries.

### **Box 5: Excerpts from the Belgian Law for a Currency Transfer Tax**

...

#### **Article 2: Area of application**

All currency transfers are subject to the tax in as much as they occur in Belgium. This includes both direct and indirect transactions. Even purely accounting transactions fall within the law.

#### **Article 3: Taxation liability**

Every person or institution which carries out a taxable transaction according to article 4 in an independent way is subject to the tax, even if it is a single transaction. Both parties to the transaction must pay the tax when a currency transaction is carried out.

#### **Article 4: Taxable operations**

All currency transactions that involve the exchange of the currency of one state for that of another are seen as taxable operations. All exchange operations of a financial nature that have the same effect as a direct currency exchange are also seen as currency transactions. This affects new financial instruments and derivatives. Goods transactions that contain currency rate risks are also seen as currency transactions.

...

#### **Article 8: Taxation levels**

The normal taxation level is 0.2 per mil of the taxed amount. For each currency transfer that exceeds the exchange rate variation band defined in article 3 will have a taxation level of 80% at most. ...

On the basis of article 2, the King has fixed a guiding rate based on a progressive mean calculated from the exchange rate development of the previous 20 days, as well as a corridor of variation about this guiding rate, above and below.

...

#### **Article 9: Exemptions**

Not subject to this tax are:

Currency transfers made by physical persons as long as they do not annually exceed the sum of 10000 Euro set by article 4 of the 11 January 1993 Law to Prevent the Use of the Financial System for the Purpose of Capital Laundering.

Currency transactions carried out by central banks and by international institutions recognised by the King as working in the area of central banks.

...

#### **Article 11: Simplification measures**

The King can allow a global taxation on large scale currency transactions for the large scale currency trade. This tax must be raised by the financial institutions engaged in the large scale currency trade.

#### **Article 12: Measures to guarantee payment of the tax and to prevent tax avoidance, tax flight and misuse.**

The King can commission revisers to present reports on the use of the present law. The revisers must be resident in Belgium and members of an international accountancy approving organisation. They can be commissioned to check the compliance of internationally active companies with the present law and seek information, which may be limited to large scale currency trading, from foreign members of an international accountancy approving organisation which have checked the consolidated accounts of the head office of such companies.

...

Transgression against the present law and against the articles of procedure will be punished according to the corresponding article 131 on tax liability.

## **6.2 The "Lula-Group" and the Landau Report**

The president of France Chirac was the first G7 country leader to actively commit himself in favour of an international tax to finance development. His predecessor, François Mitterand, had indeed favoured the Tobin tax, but without undertaking any steps towards its realisation. Chirac is the driving force of a group that includes the Brazilian president Lula, and his Chilean colleague, Ricardo Lagos. The Spanish minister president, Zapatero has also joined the group recently (Technical Group for Innovative Finance Mechanisms, known in short as the "Lula Group").

The Federal Republic of Germany is also a member of the "Lula Group" since February 2005, but it is as yet not obvious whether Berlin is just "going along with it" for its image value – for example in its efforts to gain a permanent seat in the UN Security Council – or if this will result in a serious commitment.

UN Secretary General Annan supports the group. Possibly, it can form a more long term "coalition of the willing" outside formal international organisation structures as the crystallising nucleus to pursue the international tax project. In the UN general assembly of September 2004, the then Group of Four presented a report<sup>66</sup>. It includes binding mechanisms for financing development, i.e.:

- A currency transaction tax.
- Taxing the international arms trade.
- Establishing an international finance facility.
- And the use of special IMF drawing rights to finance MDGs.

In addition to this, there is a proposal that the sending of the money of migrants to their home countries<sup>67</sup> be facilitated by reducing transfer costs, as well as improving the accessibility to micro-financing to the poor. Also, international co-operation in battling tax flight and tax oases should be strengthened and voluntary donations should be encouraged by new mechanisms such as payment by credit cards and ethical investment.

The report involves itself with the pros and contras for the individual instruments. It is especially interesting with respect to the CTT, which has been strenuously attacked by the finance community and mainstream economists. The four country leaders come to the conclusion that "*despite the obstacles referred to, a tax of very low magnitude would allow a significant, regular and predictable sum to accrue for development, without interfering with the normal function of the market*"<sup>68</sup>. 115 states in the UN General Assembly of September 2004 voted for a resolution based on this report.

The report is strongly influenced by the work of an expert commission set up by the French president under the chairmanship of the finance expert Jean-Pierre Landau. Representatives of the scientific advisory council of ATTAC France and of Oxfam International are members of this commission. The report of this commission is the most advanced document that has as yet been presented by a state on this subject. In contrast to official UN studies that must observe diplomatic niceties, and especially, avoid irritating the USA<sup>69</sup>, the report:

- Formulates a definite criticism of the structures and procedures of the ODA.
- Establishes a definite correlation between the erosion of the national tax base and globalisation.
- Derives international taxation as a logical consequence of globalisation

Just previously, the study "New Sources of Development Finance" was presented by a UN institute under the leadership of the British economist, Anthony Atkinson, which also deals with international taxation ("Atkinson Report")<sup>70</sup>. The OECD also had a report compiled in 2004. The report is generally sceptical about international taxation because - strictly neo-liberal - it would impose a cost on the private sector.<sup>71</sup>

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<sup>66</sup> Rapport Quadripartite (2004).

<sup>67</sup> These financial flows are in the range of about 80 billion US\$ per year, clearly higher than ODA.

<sup>68</sup> Rapport Quadripartite (2004): p.35/36.

<sup>69</sup> When the UNDP discovered the topic of a Tobin tax in 1996, Washington threatened to cut funds if the proposals were published in the name of the UNDP. A group from the UNDP then published the proposals publicly in a private publication. Haq et al. (1966).

<sup>70</sup> UNU-WIDER (2004).

<sup>71</sup> Reisen (2004).

### 6.3 Schröder, Blair and the IMF

At the World Economic Forum of January 2005 in Davos, the German Chancellor Schröder attracted international attention when he surprisingly referred to CTT. This part of his speech was not in the original manuscript circulated in advance, but was improvised. Since Chirac had appeared in Davos before Schröder and had, among other topics, spoken in favour of the CTT, Schröder obviously felt he had to respond. The passage in question is given in the version released on the Internet as *"if it becomes possible to draw on those financial currents, which virtually do not involve real economic procedures for financing (the MDGs, the author), and when the international community agrees on that, then it would be possible to obtain such financing. If this does not appear possible in the first instance, other paths have to be entered. Germany is prepared to take part in this debate."*<sup>72</sup> At the same time, Schroeder also strongly backed the IFF.

It cannot be said that Schröder is a committed friend of the CTT, but he nevertheless presented it as a conceivable possibility. This is in definitive contrast to the vehement rejection that appeared in a strategy paper of the Federal Finance Ministry (BMF) as recently as 2001.<sup>73</sup> Even when in 2002 the Federal Economic Ministry (BMZ) signalled its sympathy for the concept in a study concerning the feasibility of the CTT<sup>74</sup>, strenuous contradictions emanated from the BMF and the BMZ. At a meeting of the EU finance ministers (ECOFIN) of 2005, the finance minister, Eichel, said he would initially vote only for a pilot phase of the IFF, specifically for an international immunisation programme. His state secretary, Caio Koch-Weser, no longer excluded international taxation as a long-term option.<sup>75</sup> The German participation in the "Lula Group" from February 2005 underlines the fact that even the German federal Government has moved in its attitude to innovative forms of development financing. Development minister Wiczorek-Zeul then very optimistically declared: *"2005 must be the turning point year in development politics"*<sup>76</sup>.

In the meantime, it has become known that France and Germany want to commit themselves to an international air travel tax. Here, it is not yet established whether it will be an aviation fuel tax or a general fee on airline tickets.

The situation is similar in Great Britain. In the preliminaries to the G8 2005 meeting in Scotland, the British government was involved in several initiatives advanced as development-friendly, whereby the main emphasis was on IFF (see chapter 5.5). In addition to this, London proposed a new debt relief initiative mainly aimed at Africa. An Africa report commissioned by Blair established that *"It is now time that the developed world faced the fact that when debts can never be repaid, debt 'relief' just removes the fantasy assets of the creditor"*.<sup>77</sup> The British Head of Government thus declared 2005 to "Africa Year" and to be the year of decision: *"2005 is the year for decisions that will show that we are serious about the vision of a strong and prospering Africa becoming a reality"*<sup>78</sup>. Even if the reality content of such a declaration is in reciprocal relationship to its pathos, it does indicate the change in the climate of opinion.

It is then almost a sensation that the IMF and the World Bank are meantime discussing international taxation. Within the framework of the Spring 2005 meeting, a session of the Development Committee worked on a joint paper by members of both institutions on this

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<sup>72</sup> <http://www.bundestkanzler.de/-7698.780791/Rede-von-Bundeskanzler-Gerhard-Schroeder> .

<sup>73</sup> „Strengthening the international financial architecture – considerations on IMF and World Bank reform.

<sup>74</sup> Spahn (2002).

<sup>75</sup> From the conservative side, the first advocates of CTT have also emerged. The Working Group of Christian Workers in the German CDU (CDA) support the Tobin Tax (Frankfurter Rundschau, 21.6.2004).

<sup>76</sup> Speech by Heidemarie Wiczorek-Zeul at the 25th anniversary of the Brandt Report, 10th Feb. 2005.

<sup>77</sup> [www.commissionforafrica.org/english/report/thereport/cfafullreport.pdf](http://www.commissionforafrica.org/english/report/thereport/cfafullreport.pdf).

<sup>78</sup> EURODAD (2005).

theme<sup>79</sup>. Many difficulties and doubts were indeed expressed, but international taxation was not simply rejected. There were even suggestions on how to overcome some difficulties. A table rating different taxes according to various criteria such as amount of income, technical feasibility and political acceptance was compiled. Taxes on money exchanges, CO<sub>2</sub>, aviation fuel, weapons, maritime shipping, global public goods and profits of transnational companies were discussed.

However, the paper also brought an increase in value added tax into play. This indicates a trap for emancipatory politics: if a tax to finance MDGs cannot be prevented, then there should be a mass taxation such as value added tax that works digressively, i.e. the lower income groups are disproportionately affected.

## 6.4 More than Rhetoric?

Assuredly, the initiatives mentioned above, despite their frequency, do not as such produce a new quality. For this, the history of announcements not acted upon and of broken promises is too long. The UN conference on assessing the realisation of MDGs in September 2005 again offered an event – like similar meetings in the past – as a platform for publicity effective activism.

And finally, tactical interests that were anything but of a development-political nature also came into play. The new development-friendliness of the German Chancellor is of interest as the Federal Government strives for a permanent seat on the UN Security Council. For Tony Blair, the intention may well be to improve the image seriously damaged by the Iraq war as he and his party face a general election.

However, independent of such tactical motives there have been some deeper and structural reasons why development-political Business As Usual has reached its limits. The following interacting factors should be considered here:

- a. The development-political failure of neo-liberalism.
- b. The structural crisis of state finance in most industrial countries.
- c. Strategic interest divergence in the G7.
- d. The growing importance of developing countries.
- e. The growing roll of social movement

### 6.4.1 Neo-liberalism has Failed in Development Policy

After almost 30 years of experience with neo-liberal globalisation, it is increasingly obvious that the promise that all boats – the small as well as the large – would rise up to prosperity on a wave of liberalisation and globalisation has not been fulfilled. On the contrary, especially in the 1990's, the high time of globalisation, the gap between north and south, between rich and poor, widened. Not only has the debt problem of the South not been solved, it presents itself, as in Argentina, in increasingly new variants. The neo-liberal re-structuring forced on the development countries since the 1980s has failed and so has the ideological concept as formulated in the Washington Consensus. A discussion paper of the development ministries states: "*unfortunately this approach did not produce the desired results in most cases*".<sup>80</sup> Instead, some countries that obviously massively contravene the classic concept – as, for example, the People's Republic of China, and other East Asian countries – could show considerable growth and development.<sup>81</sup>

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<sup>79</sup> WorldBank (2005).

<sup>80</sup> BMZ (2004) p.3.

<sup>81</sup> BMZ (2004) p.16.

As long as the presumption that the market will bring development is hegemonic among the functional elite, they can believe that classic instruments of development financing are of secondary importance. Especially since these are tainted with the negative aura of state-interventionism. According to the Nobel Laureate Hayek, the fore-thinker for neo-liberalism, the state should limit itself to "*establishing the internal and external security, especially with regard to protecting private property, on which our social system is based.*"<sup>82</sup>

After the great financial crises in Mexico, South-East Asia, South Korea, Russia, Brazil, Argentina and the Crash of the New Economy, only the hard-line Neo-liberals argue for the Hurrah Globalisation of the 1990s. The confidence in the market has also sunk in the mainstream. Instead, the "Risks of Globalisation" are increasingly mentioned. There is still a euphemism with respect to the real existing results of globalisation, but a change in the climate of opinion can be seen. Even if it may be too early to speak of a post- neo-liberal agenda, the chances of a change in politics, and thus also for the future of development financing, have increased. So have the chances of a development-political failure of neo-liberalism.

#### **6.4.2 Structure Crisis in State Finances**

One of the results of neo-liberal politics is the structural shortage in the resources of state and local government. This is actually desired by the anti-state attitude of neo-liberalism, as expressed in the Hayek citation given above. Economically, state expenditure will always constitute an inflation risk, and so must be kept to a minimum. Of course it is argued that public services such as education, health, infrastructure, etc. are qualitatively better and made available more economically efficient when privately run. This "lean state" concept also means that reducing public debt has a higher priority, thus further limiting the financial flexibility of state and local government.<sup>83</sup>

Simultaneously, this produces pressure on state finances. On the income side, company and wealth taxation breaks away since liberalisation of capital transactions makes taxation relocation and taxation flight easier than ever before, and tax breaks are consciously offered to maintain employment possibilities. Even development financing is affected by restrictions on public funding.<sup>84</sup>

However, on the theme of public financing, it is beginning to become increasingly apparent that the race downwards cannot continue in the same way. Indicators for this are not only the increasing discussions on international taxation. The increased efforts to control taxation loopholes or the weakening of bank secrecy are further indicators.<sup>85</sup> Of especial importance in this respect is the weakening of the European Stability Pact decided on at the EU summit of March 2005 in Brussels. This was one of the supporting columns of neo-liberal dominance in the EU.

Surely, these measures are as yet insufficient and half-hearted, but they also signify that a change of thought has begun. Slightly exaggerated, it can be said that the increasingly dramatic pressure of the problem has condemned politics to seek out new sources of revenue.

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<sup>82</sup> Hayek, Friedrich August von, interview in Feb. 1981, in *Wirtschaftswoche* no. 3/11.1.96, p. 16/17.

<sup>83</sup> There is no space here to prove that these assumptions are neither theoretically sustainable nor empirically correct. There is plenty of literature to refer to, for instance Schui/Blankenburg (2002) and Huffs Schmid (2004).

<sup>84</sup> There are additional factors: after the end of the Cold War, a strategic dimension linked to development aid since the 1940s became obsolete. Since the social question has returned to the industrialised countries, the public acceptance has also diminished. It remains to be seen whether events like the tsunami in the Indian Ocean will change this attitude in the long-term.

<sup>85</sup> The Swiss banking secret, the most notorious instrument for tax evasion and money laundering, has slightly been touched in an agreement between Switzerland and the EU in 2004. In Germany, the „Law for Promoting Tax Honesty“ was enforced in April 2005.

The discussion on innovative financing instruments and international taxation also takes place in a more favourable environment than was the case in the last two decades.

### 6.4.3 Divergence of Strategic Interest in the G7

The USA tried to harness the G7 and other important actors in world politics for its "Global War on Terror" after the terror attacks on the World Trade Center. By the time of the Iraq war, it was clear that neither "Old Europe" nor heavyweights under the more rapidly developing countries such as China, India, and Brazil, amongst others, were prepared to submit to this strategy for any length of time. Their own flexibility and interests were affected too much.

So, alternative projects were sought. Among these, the idea of "War Against Poverty" was definitely an interesting candidate. The informal alliances or "Coalitions of the Willing", as the above mentioned "Lula Group" was called, are the starting points for this. Similar procedures were already practised by the establishment of the "International Court of Justice" or by the "Kyoto Protocol". It is within the logic of a unipolar power configuration that the other actors should combine into changing alliances concerning single themes – without or against the leading power. In this way they maintain or extend a certain measure of flexibility. This can be a tendency that restructures the international system in the long term.<sup>86</sup>

This form of "multilateralism minus one" also has its price. Rhetoric alone is no longer sufficient to win over allies from the south or the UNO for a project. If the strategy is to be credible, a minimum of compromise is indispensable in the face of the catastrophic development-political record of the industrial countries over the last 20 years. In this way, solid motives for the G7 states to increase their development-political commitment also results from this geo-strategic constellation.

This is underlined by the fact that the UNO also tried to distance itself from the US war on terror. A high-ranking panel presented its report in December 2004 committing the UN General Secretary Kofi Annan to analyse the worldwide threats and challenges. The report is interesting in that the threat concept used results from other priorities than those conceived as the threat scenarios used by the US strategists. *"Every event and every process that contributes to the death of many people or reduces their prospects of life and that undermines the supporting elements of the international system is a threat to international security."*<sup>87</sup> Thus, economic and social threats, including poverty, infectious diseases and destruction of the environment are also a threat to collective security. The MDGs are then explicitly declared to be components of a comprehensive security policy.

### 6.4.4 The Political Weight of the South is Increasing

The failure of the WTO conferences of Seattle and Cancun show that the developing countries are no longer prepared to unconditionally submit to the northern agenda and remain in a one-sided state of dependence. This is more than just the ability to say no or even that the "powers of chaos" are behind this. On the contrary, this represents real changes in political power. Thus, the world-political weight of some of the more rapidly developing countries such as China, India, Brazil or South Africa has grown considerably. In this case, it is not only their economic potential, their population densities or their regional influence, but also the new global dimensions of a new problem-situation that makes the readiness of the industrial countries to co-operate imperative.<sup>88</sup> One has only to reflect on the ecological consequences

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<sup>86</sup> This does not exclude co-operations with the leading power, be it because of interest, be it because the leading power is capable to constrain others. (2004)

<sup>87</sup> UNO (2004): p.12.

<sup>88</sup> Excluding military „solutions“.

of the enormous growth rate in China or the economic and political consequences of their growing consumption of the increasingly scarce oil resources.

As well as this, the developing countries are increasingly able to organise themselves into informal coalitions. Thus, the role of so-called G20 was of decisive importance at the WTO meeting in Cancun. This was not only an affair for the more rapidly developing countries, in the meantime, the African states have also organised themselves in this way in the WTO, so that their interests can no longer be by-passed.

Together with the contradictions between the USA and the other G7 countries sketched out above, additional room for manoeuvre is opening up for developing countries. They can strengthen their bargaining position when they learn how to cleverly use the contradictions in the WTO. Since the end of the block-free movement, there have been hardly any self-organising procedures for developing countries, and this new trend can bring in a historically new stage in North-South relations. This does not mean that the chances for combating poverty automatically increase, because the differences among the developing countries are simultaneously increased. In this way, LDCs especially can be pushed to the sidelines. However, the prevailing power-political conditions have become more porous in comparison to the hermetic sealed relationships of the 1990's and the options for alternatives have increased.

Last but not least, international taxation should have a high acceptance among developing countries, as long as they are the beneficiaries.

#### **6.4.5 Global Social Justice Movement**

A new actor became visible on the world-political stage with the spectacular protests against the WTO in Seattle: the social justice movement, or globalisation-critical movement<sup>89</sup>. It was more or less professionalized Non-Government Organisations (NGOs) that in general carried the banner of criticism and opposition, at the Rio conference, as a rule along single-issue lines. Now, the new social movement (whereby many NGOs are part of this movement) goes much further. In contrast to the 1990s, the new movement is different because

- It can mobilise mass movements of the order of millions for protest actions.
- A considerable variety of different social groups have learned to join together politically.
- It enjoys a considerable acceptance within the media and the public in some countries.<sup>90</sup>
- It no longer argues along single issue lines, but questions neo-liberal globalisation as a whole, and consequently tries to formulate comprehensive alternatives.
- It has the beginnings of an international structure to develop ways of acting internationally independent of governmental events as is the case with the so-called Social Forums at global (Porto Alegre), continental and regional levels.

The movement could encourage politicising processes that influence the climate of opinion in many countries, and with its slogan "Another World is Possible" can break the hegemony of the "TINA-principle" (There Is No Alternative).

Numerous activists in the movement play an active role in the discussion about innovative instruments for financing development, especially with respect to international taxation. The

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<sup>89</sup> Within the English language context, this is usually called the „anti-globalisation movement“ or „no globals“ for short, in Latin languages „altermondialistes“ or „altermondialista“. The varying terms have political implications and reflect the political power relations.

<sup>90</sup> For instance France, Italy, Brazil, India, Scandinavia, and also Germany with restrictions.



most known organisation criticising globalisation, ATTAC, was even founded to establish an international tax, the Tobin tax. This is even incorporated in the name "ATTAC"<sup>91</sup>.

The conditions for new ways of financing development have also improved compared with the 1990s because of the rise of the globalisation-critical movement and its influence on public opinion, political parties and governments.

## 6.5. New and Better Prevailing Conditions

In view of the tendencies described in this chapter, it appears justified to speak of the generation of new and more favourable prevailing conditions for the future of development financing. That does not mean that all dreams of a bloom period by civil-society will immediately ripen. Many of the old blockades still exist, for example:

- The USA vehemently rejects international taxation. This, for one, is because the only super power cannot bind itself to multilateralism and structures of global governance without difficulty, since this would necessary follow with international taxation. It would also mean giving up part of national sovereignty since taxation has been a centuries-old prerogative of national states. Additionally, in the political culture of the USA, an animosity towards the government, particularly with regard to taxation is traditionally especially deep-rooted. The rejection of international taxation has a basis within the population. Thus, it is not surprising that the US taxation law requires that the contributions to the United Nations are explicitly linked to the condition that the *"UN undertakes no effort to introduce or impose a taxation of any kind on US citizens to provide funds for the United Nations or one of its organisations"*.<sup>92</sup> But this barrier has lost significance with the growing readiness of other G7 states to act, if necessary, without the US.
- The economy and its associated academic environment and media are in strong opposition because they fear that an international tax will reduce their profits and/or negatively influence their competitiveness. This applies, for example, to the financial services industry, which has strongly fought the CTT for years. The airlines lobby immediately announced its opposition when it appeared that an international tax on air travel could possibly soon come at the EU finance ministers meeting of February 2005.
- The complexity of multilateral agreements. Even when the political readiness to establish an international tax is given, the formulation of such a taxation system would be more tedious and difficult as it would be within a national framework.

The positive changes in the prevailing conditions still allow the conclusion that presently a "window of opportunity" has opened. Even if this window has only barely opened, it is important to recognise it. For then, efforts can be made that contribute to opening it completely. The chances for this definitely exist in a real political sense, as shown by the agreement between the French and the German governments concerning taxation of international travel. It is understood that civil society cannot limit itself to this, and that one of its strengths also lies in putting items on the agenda for which the shortness of breath of daily politics has no energy.

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<sup>91</sup> ATTAC = Association pour la taxation de transferts financiers à l'aide des citoyens et citoyennes; association for the taxation of financial transfers in support of the citizens.

<sup>92</sup> For the fiscal year 2004 see Public Law 106-113 of 29 November 1999 (H.R. 3194) Section 561. The law exists since 1997.

## **7 Direction of Action**

The theme of international taxation is not only crucial because of the conjuncture of MDG discussions. It is inherent in globalisation and so will not go away from the daily agenda. On the contrary, the problem pressure resulting from globalisation means that it will increase. This means new chances for emancipatory activists in civil society and in the official political system, in parliament and the political parties. An emancipatory discourse on international taxation contains an enormous (contra)-hegemonic potential, since it is directed towards two basic goals:

- Redistribution from rich to poor (via tax imposition).
- Political regulation of globalisation (via the directing effect of taxation).

It cannot be predicted how quickly successes can be achieved in this way. In any case, it will be a long process, in the course of which many strategic and tactical questions will arise as well as material issues. Some of these can already be seen.

### **7.1 Don't Play Instruments against Each Other**

The various taxes and other instruments should not be set against each other. The environmental movement will certainly have great sympathy for all environmental taxation. However, if the environmental movement wants to achieve long-term success, it must strive to link the environment with the social aspect and with development. The directing effect of CTT and other taxes is an important resource to change the economic power relationships in favour of the majority of the population of the planet. Without this change in the power relationship, substantial gains will not materialise – see the Kyoto Protocol. On the other hand, social movements, to which the social question is central, cannot pursue their objectives while remaining blind to the ecology. That applies also to the current discussions regarding CTT and air travel taxation. Independent of which will first be realised, air travel taxation is too small to provide a significant contribution to MDGs. The CTT is thus still needed, with its great revenue potential. And conversely, CTT does not make the ecological effect of an air travel tax superfluous.

A dimension of this question is also that international taxation does not replace the increase in ODA to 0.7%, nor the efforts up to now to structurally change the world economy, such as for writing off debt, for a socio-ecological transformation of world trade and a socially just and development friendly architecture of the international finance system. And finally, international taxation should not be misused to continue the practice of neo-liberal conditionality. Naturally, it should be guaranteed that new resources for eliminating poverty and solving the other problems of sustainable development are going to be used. It should be left to an individual country to choose whether it wants to be liberalised, deregulated or privatised.

### **7.2 Link up to Other Interests**

The taxation theme also has an enormous (contra)-hegemonic potential because it can lock on to such socially important debates as taxation justice and financing the social state. The Boston Tea Party and the French Revolution already shows the historical importance of the question of taxation.

Even if one does not think in such dimensions today, the subject is not only of importance to the development-political community or the environment movement. It is among the socio-political questions that move the broadest population groups. Unions, social groups, as well as the middle class economy are all interested in an alternative to neo-liberal taxation policy.

Slightly exaggerated, it can even take over pub conversation without emancipatory politics having to be ashamed for being mentioned.

### 7.3 Realpolitik versus Utopia?

International taxation is a new subject. This in itself makes the subject controversial. But, what is more important, every kind of progressive taxation will face the resistance of powerful economic and financial interests and their advocates in academia, politics and media. And, as in the case of the CTT, when the factual argumentation runs out, the concept will be discredited as unrealistic and utopian.

But one does not have to submit to this. The opinion climates can change. But it will not do this without emancipatory activists actively contributing to the change. Thus, what appears to be utopian today can tomorrow become necessary because of the pressure of the problems. The German philosopher Schopenhauer said that a good idea always goes through three phases: it is declared stupid in the first phase, it is fiercely fought in the second phase, and it is implemented in the third phase.

In this sense, the last word can be left to the Landau Commission report, which closes with the conclusion that “...*there is a need to forge a civil and political momentum, aimed at building enduring coalitions. It is worth noting in this respect, that successful campaigns to mobilize public opinion often depend on the breadth and innovative character of the visions they project. This should serve as a reminder not to jettison major taxation ambitions in the name of short-term political realism. The best strategy is not to eschew grand visions, but rather to move toward them step by step.*”<sup>93</sup>

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<sup>93</sup> Landau (2004): p.102., cited from the English translation, p. 80.

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## List of Abbreviations/ Glossary

|          |  |
|----------|--|
| ATTAC    | Association pour la Taxation de Transfers Financiers à l'Aide des Citoyens et Citoyennes   |
| BIS      | Bank for International Settlements   |
| BMF      | Federal Ministry of Finances, Germany (Bundesministerium für Finanzen)   |
| BMZ      | Federal Ministry for Economic Co-operation and Development (Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung)  |
| CHAPS    | Clearing House Automated Payment System – English electronic payment system  |
| CLS      | Continuous Linked Settlement – payment system of big banks   |
| CTT      | Currency Transaction Tax, also known as Tobin Tax after James Tobin or, as a modified two-phase-model, Spahn Tax after Paul Bernd Spahn  |
| EcoFin   | Council of the Economic and Finance Ministers in the European Union  |
| ERND     | Exchange Rate Normalisation Duty: Extension of the Tobin Tax by a second step of an increased tax rate in case of unusual currency fluctuation   |
| EURODAD  | European Network on Debt and Development (NGO)   |
| FDI      | Foreign Direct Investment  |
| Fed Wire | US-American electronic payment system (Fed – Federal Reserve/ US Central Bank)   |
| FFD      | Financing For Development: Process since the Monterrey Consensus, the agenda includes debt relief and international taxation   |
| FSF      | Financial Stability Forum, founded by the G7 in 1999   |
| G7       | Group of 7 – Presidents of the large industrialised countries Germany, France, Great Britain, Italy, Japan, Canada and USA   |
| G8       | Group of 8 – G7 plus Russia  |
| G20      | Group of 20 – Finance ministers and central bank presidents of the G8 and some newly industrialising countries   |
| GDP      | Gross Domestic Product: Value of all goods and services produced domestically within one year ( <i>domestic concept</i> )  |
| GEF      | Global Environment Facility  |
| GNI      | Gross National Income: Value of all goods and services produced by permanent inhabitants of one country within one year, known as Gross National Product until 1999 / term changed due to European standardisation |
| GPS      | Global Positioning System: satellite-based navigation system for global positioning especially in aviation and maritime navigation; run by the US Ministry of Defence  |
| HIPCs    | Heavily Indebted Poor Countries  |
| IATA     | International Air Transport Association  |
| IFF      | International Finance Facility   |
| IOPC     | International Oil Pollution Compensation Fund  |
| ITU      | International Telecommunication Union – UN Sub-organisation for licensing the utilisation of space by satellites et al.  |
| IMF      | International Monetary Fund  |
| LDCs     | Least Developed Countries  |

|                      |   |
|----------------------|---|
| MDGs                 | Millennium Development Goals: decision and catalogue of aims (income, education, etc.) issued by the UN General Assembly in 2000 to reduce poverty by half until 2015   |
| Monterrey Consensus  | Conference with participation of the UN (for the first time on financial questions), 2002 in Monterrey/ Mexico; modest beginning to emphasize the necessity of financing instruments like for instance debt relief and international taxation as an alternative to the Washington Consensus on the political agenda |
| NGO                  | Non Governmental Organisation   |
| ODA                  | Official Development Assistance   |
| OECD                 | Organisation for Economic Co-operation and Development  |
| OFC                  | Offshore Centre / tax paradise  |
| PPP                  | Public Private Partnership  |
| SWIFT                | Society for Worldwide Interbank Financial Telecommunication   |
| TARGET               | Trans-European Automated Real-time Gross Settlement Express Transfer System   |
| TNC                  | Transnational Corporation   |
| UNCED                | United Nations Conference on Environment and Development, 1992 in Rio   |
| UNDP                 | United Nations Development Programme  |
| UNEP                 | United Nations Environment Programme  |
| UN(O)                | United Nations (Organisation)   |
| UNU-WIDER            | United Nations University/ World Institute for Development Economics Research   |
| Washington Consensus | Conference of representatives of international organisations and scientists in 1990 in Washington D.C.; Agreement on privatisation, deregulation, budget constraints, etc. as a development policy concept – has increased poverty  |
| WBGU                 | Scientific Council of the Federal Government for Global Environmental Changes   |
| WHO                  | World Health Organisation   |
| WTO                  | World Trade Organisation  |