NOT ANOTHER TAX

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Why would anyone in Australia advocate the introduction of another tax? Australia already has a complex range of taxes and the last thing most Australians would say they need is yet another tax. Despite this, this paper is proposing a tax, called the Tobin tax, be imposed on foreign currency transactions.

The aim of a Tobin tax is to actively distort resources away from speculative currency dealing by imposing a small flat tax on all currency trading. The success of the tax would be measured not by how much revenue it raises but by how little revenue it raises.

The Tobin tax would be a good tax because, as it operated to reduce currency speculation, it would strengthen the control that the Australian government had over Australian monetary policy. Other countries that elected to levy a Tobin tax and join the Tobin Tax Zone (the Zone) would also regain control over their monetary policy.

American economist, James Tobin,1 first proposed the introduction of a small tax on foreign currency transactions in 1972 in order to slow what he predicted would be an enormous growth in foreign currency speculation after the collapse of Bretton Woods2 and the ‘freeing’ up of currency trading and floating of currency. Tobin was ahead of his time and his fears of the instability the currency gambling would engender have since been realised at the corporate, national and regional level.

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1 Krugman P, ‘Vale James Tobin’ published by the Evatt Foundation (22 March 2002) http://evatt.labor.net.au/news/105.html. James Tobin 1918–2002, was a professor at Yale University, a Nobel laureate and an advisor to John F Kennedy. Tobin was the economist credited with bringing Keynesian economic ideas to America. Tobin is remembered for two main policy ideas, firstly, as the force behind the Kennedy tax cuts that purportedly started the economic boom of the 1960s. Secondly, Tobin was the first to propose a small tax on foreign currency transactions to discourage currency speculation, the subject of this paper.

2 J Eatwell, and L Taylor, Global Finance at Risk: The Case for International Regulation (Polity Press, UK 2000) 1. The Bretton Woods system to manage global finance was determined in 1944 in Bretton Woods, New Hampshire. ‘A fundamental aspect of the system was that exchange rates between major currencies were fixed in terms of the [US] dollar, and the value of the dollar was tied to gold at a US guaranteed price of thirty-five dollars per ounce.’
I CORPORATE CURRENCY CRISES: AWA AND THE NAB

A The AWA Debacle: Lessons Not Learnt

AWA Ltd (AWA), an Australian based public company and electronics group, had the dubious honour of being one of the ‘first losers of the modern era with a $35 million loss through bets on the foreign exchange markets’. 3

In 1987 these foreign exchange losses resulted in a public dispute between AWA and its auditors over who was responsible for the foreign exchange dealing losses. The reported losses in the legal proceedings were stated to be $49.8 million. 4 The court case assigned responsibility for the undetected actions of a single employee who had turned two years reported profits into losses. The courts apportioned the blame between AWA’s chairman of directors and AWA’s auditors. 5

This early example of gambling on foreign exchange fluctuations should have been an example to corporations with foreign exchange desks. They should have been aware of the risks involved in uncontrolled gambling with company funds and on the duties of board members to regulate such gambling if the corporations include this as part of their normal operations.

B The NAB Debacle

The NAB currency trading loss debacle of 2004 demonstrated that, 17 years after the AWA currency trading losses, the management of the NAB did not fully recognise the dangers of currency speculation.

The currency trading losses at the NAB were revealed by a whistleblower 6 in January 2004. The currency losses at that stage were estimated at $180 million. NAB’s General Manager of Group Corporate Affairs, Robert Hadler, assured the reporter that even without the actions of the whistleblower, ‘I think our systems would have picked it [the illegal trading and associated losses] in due course’. 7 The losses had been building, undetected by NAB management, for four months when revealed to NAB management, not by NAB internal control systems, but by a whistleblower. The reporter did not question Robert Hadler as to the meaning of the term ‘in due course’, and when that might have been. Two weeks after the radio interview 8 the currency trading losses were confirmed at $360 million.

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4 Daniels and Others (Formerly Practising as Deloitte Haskins & Sells) v Anderson and Others (1995) 37 NSWLR 438, 444.

5 Ibid 439.


7 Ibid.

Two months after the losses were made public, the industry regulator, the Australian Prudential Regulation Authority, had found that the NAB had ‘shoddy internal controls over its currency trading arm’.

**C National and Regional Currency Crises**

Economists at the Federal Reserve Bank of St Louis defined a currency crisis ‘as a speculative attack on a country’s currency that can result in a forced devaluation and possible debt default’. Even the International Monetary Fund (IMF) recognises the fact that currency crises are caused by ‘speculative attacks’ on currencies caused by ‘the unreasoned panic in financial markets’. Even though the attack on a currency does not stem from any reasoned analysis of the economy under attack the result of the subsequent panic is real. The damage done by unreasoned panic is permanent damage to a country’s economy as the two following examples show.

1 Korea

The Korean currency crisis in late 1997 resulted in the Korean won depreciating by 112% against the US dollar while the stock of foreign exchange reserves went down from 22.3 billion to a mere 3.8 billion US dollars bringing the country to the brink of sovereign default. More than 17,000 companies went bankrupt including eight conglomerates in 1997.

This crisis was caused by the flight of speculative capital out of Korea. The flight of capital was caused by panic, not by any underlying problems with the Korean economy that was growing strongly at the time of the crisis.

In Korea, the panic caused the GDP growth rate to fall from 7 per cent before the crisis to a decline in the GDP of –5.8 per cent after the crisis. The GDP growth rate recovered after the crisis but ‘the level of GDP remains permanently below its initial trend after the crisis’.

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10 Ibid.


13 Ibid.


16 Ibid.
2 Mexico

In 1994 the Mexican economy was enjoying ‘economic growth, which averaged 3.1% per year between 1989 and 1994. In 1993 inflation was brought down to single-digit levels for the first time in more than two decades’.17 Yet, in December 1994 when the peso was devalued by 15 per cent, it precipitated a ‘financial crisis’.18 This crisis ‘wiped $US75 billion off Mexican securities held by foreigners’.19 As a result there was a panicked ‘exodus of capital’.20

What Mexico had done was to liberalise their economy so that banking and investment rules were deregulated. This allowed for the operation of private banks and for a large influx of foreign investment in the Mexican economy.21 ‘The Mexican currency crisis, unlike many others in Latin America, was not the result of irresponsible fiscal behaviour.’22 It was the result of allowing the economy to become dependent on ‘massive … short-run foreign capital inflows’23 which became capital outflows in what was called a ‘financial panic’.24 These foreign capital inflows were given a boost when the US Congress approved North American Free Trade Agreement (NAFTA) with Mexico.25 The panic meant that Mexico had to accept a ‘$52 billion international support package intended to forestall a default and to bolster confidence in the Mexican economy’.26 The Mexican economy had been strong and growing before the crisis caused by speculators.

3 The Australian Position

The Australian economy is enjoying strong economic growth relative to many developed economies with ‘an average annual growth rate of 4.0% from “real” GDP from 1992 to 2001, it is higher than any of the ‘G7’27 countries’.28 The Australian economy also shares with Mexico the fact that it has:

http://www.cato.org/pubs/journal/cj17n3-14.html Gil-Diaz is the former Vice Governor of the Bank of Mexico.
18 Ibid.
19 Above n 3, 30.
20 Ibid.
22 Ibid 16.
23 Ibid 21.
24 Ibid 15, 17.
25 Above n 17, 4.
26 Above n 21, 18.
27 The ‘G7’ group of countries, also referred to as the ‘G8’, consists of the major industrial democracies of France, the United States, Britain, Germany, Japan, Italy and Canada. Russia has been included in the G7 discussions since 1991 and will become a full member in 2006. (http://www.g7.utoronto.ca/what_is_g8.html)
• deregulated the banking sector
• privatised many utilities
• deregulated its currency trading and capital flows
• negotiated a Free Trade Agreement with the United States.

The Australian economy is just as vulnerable as the economies of Mexico and Korea to the actions of currency speculators.

4 The Asian Currency Crisis

An example of regional currency related speculation was the Asian currency crisis of 1997. This 'lowered the world growth projection for 1998 by one percent and increased worldwide unemployment by 10 million'.

The Asian currency crisis was precipitated by the ‘floating of the Thai baht on July 2 [1997] and consequent 35 percent decrease in its international value prompted a generalized currency attack on almost all the Southeast Asian currencies’. The countries most seriously affected by the Asian currency crisis were Thailand, Indonesia, Malaysia and Korea and ‘[t]hese countries contain about one-tenth of Asia’s population’. The ‘serious economic dislocation’ that had occurred in these four countries did in 1998 transmit ‘economic contraction, currency depreciation and reduction in imports’ in other major economies, including the Philippines, Singapore, China and Hong Kong.

What caused the currency crisis in Thailand and how did the crisis in Thailand infect its neighbours?

At the time of the Asian currency crisis newspaper commentators were blaming ‘crony capitalism’, an unhealthy closeness between government leaders and business leaders, for the crisis. A simple Google search linking crony capitalism to the Asian currency crisis resulted in 7580 ‘hits’. However, after the dust of the crisis had settled, the IMF concluded that the Asian currency crisis occurred despite ‘several decades of’

32 Ibid.
33 Ibid.
34 Ibid.
35 Ibid.
outstanding economic performance36 and ‘even though government budgets were broadly in balance and inflation rates were modest’.37 In other words, the crisis happened despite, as economists say, good economic fundamentals.

Three Asian countries not affected by the currency crisis were Vietnam, China and India. These very different economies share the fact that they impose heavy controls on their capital movements.38 Capital controls can give rise to other problems, some of which are listed below:

- the emergence of a black market in the currency being controlled,
- the cost of imposing controls, and
- problems in attracting foreign investment.

An alternative to capital controls is a free market in currencies but with speculation being ‘controlled’ by the imposition of a Tobin tax.

D The Tobin Vision

There are two ways of protecting economies from currency speculators. One is the imposition of currency controls with its attendant disadvantages, and the other is controlling the volume of currency speculation. Some of the disadvantages of imposing currency controls are:

- the potential emergence of a black market in the currency being controlled,
- the cost of imposing controls, and
- problems in attracting foreign investment if potential investors don’t have the confidence of free capital mobility.

Since the deregulation of Australia’s currency market in the 1980s, currency speculation here has grown so that now 49 out of every 50 foreign currency transactions are purely speculative.39 This is typical of the experience in other countries. This level of gambling with the foreign exchange makes the currency, and therefore the underlying ‘real’ transactions, vulnerable to artificial fluctuations in currency values.

Tobin’s suggested imposition of a very small tax of 0.2 per cent on currency transactions would have a negligible effect on commodity trade and long-term foreign investment. In 1996 a group of economists, supported by the United Nations Development Programme, conducted studies into the feasibility of the Tobin Tax.40 In the prologue to the book, where the results of these studies appeared, Tobin wrote:

Most disappointing and surprising, critics seemed to miss what I regarded as the essential property of the transactions tax—the beauty part—that this simple, one parameter tax would automatically penalise short-horizon round trips, while

37 Ibid.
38 Above n 31, 4.
39 Stilwell Frank, Changing Track, (Pluto Press, 2000) 226
negligibly affecting the incentives for commodity trade and long-term capital investments. A 0.2% tax on a round trip to another currency costs 48% a year if transacted every business day, 10% if every week, 2.4% if every month. But it is a trivial charge on commodity trade or long-term foreign investments.41

A Tobin tax has been resisted because of the fear that such a tax would push currency transactions into tax havens.42 However, there would be no revenue or economic loss to nations like Australia because currency transactions that are based on a ‘real’ sale or purchase could not move offshore because the good or service is either being sold from Australia or to Australia. Furthermore, corporations could be affected by loss of what they consider to be profitable trading in currencies unless they have had an AWA or NAB experience, or have not learnt from the experience of these companies.

1 Tax Evasion

Patomaki believes that using the possibility of tax evasion as an argument against imposing the tax is fallacious because it does not make tax evasion right or imposing the tax immoral.43 With foreign exchange (‘forex’) players either inventing financial substitutes for currency transactions, and/or locational substitutes for booking forex trades,44 tax evasion could be a serious problem. Tax evasion could make the imposition of the tax ineffective; however, if forex players invent financial substitutes, the tax could be extended to cover the new financial instruments.45 If the tax is not universal when it starts, which it won’t be, then members of the Tobin Tax Zone (the Zone) ‘can make the banks residing in the tax-free areas pay a higher tax on cross-border credit to non-residents of the Zone. This should prevent banks from transferring funds to the rest of the world for forex purposes’.46 Quiggan suggests that separating the Zone from the rest of the world could be ‘an advantage in the context of internationally supported prudential regulation’.47 He suggests countries that choose to operate outside the Zone and their accompanying regulations do so ‘in the knowledge that they would not have access to the IMF if things went wrong’.48 Financial institutions that chose to operate outside the Zone ‘would be unable to borrow from central banks or the institutions operating within their prudential control’. 49

Considering the IMF analysis of the causes of, and the detrimental effects of, currency speculation on countries and regions, this would probably become IMF policy.

41 Ibid xi.
42 Ibid 227.
43 H Patomaki, Democrratising Globalisation: The Leverage of the Tobin Tax 139.
44 Ibid 137.
46 Ibid 155.
48 Ibid.
49 Ibid.
The members of the Zone could also enforce the international consequence of Tobin tax evasion attempts by corporations.

II CONCLUSION

The major danger of massive unregulated currency speculation is loss of sovereignty. When countries cannot defend their currency they effectively lose control of their national monetary policy. The volume and volatility of unregulated currency flows can threaten national currencies with devaluation, higher interest rates and financial crises. This can lead to nations suffering low economic growth, increases in unemployment and inability to implement domestic policy.\textsuperscript{50}

Concern about protecting national economies from speculative attacks on currencies has led to the Tobin tax being introduced in Canada,\textsuperscript{51} while also being actively considered in the United Stated and by the European Union.

On 11 April 2000, a private members’ Bill was introduced to the US Congress entitled ‘US Congress Concurrent Resolution on Taxing Cross-Border Currency Transactions to Deter Excessive Speculation’.\textsuperscript{52} In September 2003, 30 members of the European Parliament and 10 members of national parliaments from 15 countries published an open letter calling for the introduction of a Tobin tax.\textsuperscript{53} This was after the issue of a Tobin tax was raised at the European Parliament in June 2000.\textsuperscript{54}

Recent advocacy for the introduction of a Tobin tax is a signal that even the largest economies are not immune to the negative effects of currency speculation and are dealing with the need to protect their currencies from attack by speculators. International activity pressing for a Tobin tax is the beginning of a global response to a global problem. Australia should ready itself for admission into the Zone when introduced by either the European or European/American countries by legislating for the Tobin tax now (as Canada has already done). The Tobin tax is the only well regarded proposal gaining international credibility, which may control currency speculation without the reimposition of currency controls.

\textsuperscript{50} Ibid.

\textsuperscript{51} Tobin Tax Motion Passes in Canada’s Parliament, Centre for Environmental Economic Development, www.ceedweb.org/iirp/canadames.htm. The Canadian Parliament set the rate of tax at 0 per cent until it is adopted by other countries.

\textsuperscript{52} Peter DeFazio, and Paul Wellstone, congressmen, US Congress Concurrent Resolution on Taxing Cross-Border Currency Transactions to Deter Excessive Speculation (H.Con.Res.301) introduced 11 April 2000, www.ceedweb.org/iirp/ushouseres.htm

\textsuperscript{53} World Parliamentarians Call for a Tobin Tax http://tobintaxcall.free.fr/

\textsuperscript{54} Capital Tax, Fiscal Systems and Globalisation Intergroup, preparatory note to the first inter-parliamentary meeting on the Tobin tax at the European Parliament on 28 June 2000.