MEETING THE MILLENNIUM PROMISE

Report of the All Party Parliamentary Group for Debt, Aid and Trade into the requirement for additional development financing to fund the Millennium Development Goals

House of Commons

ALL PARTY PARLIAMENTARY GROUP FOR DEBT, AID & TRADE

In 1970 the world's richest nations agreed to give the world's poorest countries 0.7% of their gross national income to help bring them out of poverty. Thirty-seven years later the target still has not been reached. In 2007 – at the half-way point for the achievement of the Millennium Development Goals – new sources of aid revenue are a vital way forward.

ABOUT THE AUTHOR

Phil Thornton was Economics Correspondent at *The Independent* between 1999 and 2007. In 2007 he won the title of Print Journalist of the Year in the WorkWorld Media Awards run by the Work Foundation. After a 15-year career as a business journalist for newspapers and news agencies, Phil has recently set up Clarity Economics (www.clarityeconomics.com), a consultancy and freelance writing company looking at all areas of business and economics including fiscal policy, tax and regulation, macroeconomics, world trade and financial markets.

Additional research and editing by David Hillman, Paul Kirby and Claudia Waller.

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Executive summary

The UK is a world leader in working towards the elimination of poverty. In 2005 we announced a timetable for Official Development Assistance (ODA) to reach 0.7% of Gross National Income (GNI) and, through our presidency of the G8, persuaded all European countries to do the same. The UK is renowned as a pioneer on debt relief and untying aid. However, far more needs to be done if we are to live up to our compact with the world's poorest people to deliver the Millennium Development Goals (MDGs) by 2015. The UK needs to show leadership for a renewed effort to increase development resources. Without additional finance, meeting the MDGs can be no more than an empty promise.

Before the 2005 G8 summit, Oxfam warned that if current trends continued and the world failed to meet the MDGs, by 2015:

- 45 million more children will have died;
- 53 million more people in Sub-Saharan Africa will not have access to proper sanitation; and
- 247 million more people will still be living on less than $1 a day

than would have been the case, had the targets been achieved.

More funding is desperately needed but budgets are already over-stretched and demands upon them continue to grow. Innovative solutions must be found. The world cannot meet the Millennium Development Goals without additional, long-term and predictable sources of finance to supplement current planned aid spending.

There is a growing political consensus about the need for innovative financial instruments to complement existing official aid budgets. The UK-led International Finance Facility for Immunisation (IFFIm) and the French-led UNITAID have recently been launched, generating $1.3 billion between them for vaccinations and HIV/AIDS, TB and malaria treatments. These initiatives are a vital start and set an important precedent, but each has limits that indicate a need for a new set of funding instruments.

A number of different possible financing streams were suggested to this Inquiry. Given the urgency of meeting the MDGs, this Report focuses on the Sterling Stamp Duty (SSD) – a proposal that appears well researched, technically sound and has the potential to raise considerable funds in addition to the UK's ODA commitments almost immediately. Furthermore, owing to the UK's established leadership role in this field, there is a real possibility of encouraging like-minded nations to follow suit, increasing dramatically the potential revenue that could be generated.

> *I am now convinced that a sterling stamp duty would be simple for the UK to adopt, would be difficult for any bank to evade and would be possible for most countries to imitate.*
>
> Professor Avinash Persaud, former head of currency research at JP Morgan, UBS Phillips and Drew and State Street Bank, President of Intelligence Capital and former Visiting Scholar at the IMF

Based on the evidence put before this Inquiry by some of the world's leading experts in this field, the All Party Parliamentary Group makes the following key recommendations.

That the UK Government:

- **Undertake rigorous research in an open and transparent manner into the implementation of a 0.005% stamp duty on all sterling foreign exchange transactions to provide additional revenue to help bridge the significant funding gap required to meet the Millennium Development Goals.**
- **Ensure that the UK and any other countries that implement currency transaction development levies adhere to the principle that this finance is additional to aid already committed to reach the 0.7% target of GNI for ODA.**
- **Work with other like-minded countries to research, develop and urgently implement other new sources of development finance.**

> *At this low rate, the sterling stamp duty is an entirely feasible proposal.*
>
> Joseph Stiglitz, University Professor of Economics at Columbia University and Nobel Laureate

1 Our compact with the world's poor requires action not words

In the year 2000, in an atmosphere of hope for a new century and a new millennium, all UN member countries signed up to eight Millennium Development Goals to be achieved by 2015. Half way to that date progress has been painfully slow. Without a significant increase in aid volume, this compact with the world's poorest people will go unfulfilled.

If we do not do more than we are doing at the moment, we will miss crucial targets like halving the number of people who suffer from hunger and reducing the spread of HIV/AIDS. These human disasters will occur during a period of unparalleled prosperity for the inhabitants of the world's richest nations.

Evidence shows that aid does work. It saves lives, addresses injustice and creates opportunity. Because of aid and debt relief, 34 countries are now on track to meet the infant mortality goal, 44 countries are now on track to meet the poverty goal and the number of children out of school has fallen from 100 million to 77 million. Yet to honour our compact and meet the MDGs, we need to do more.

2 Beyond traditional aid assistance

While wealthy nation governments have made marked progress in cancelling debts for the poorest countries they are considerably off track to meet their commitment to spend 0.7% of their gross national income on official development assistance. This failure to meet the 0.7% target agreed in 1970, and instead only very gradually increase aid volume, has cost countless lives and livelihoods. Despite a commitment from the UK to finally reach this target by 2013, without new and additional money it looks increasingly unlikely that the MDGs can be met by 2015.

The world's richest nations must deliver fully on long-standing commitments to achieve 0.7% GNI – in particular, the G8 industrialised nations must live up to their 2005 pledge to double aid to Africa by 2010 and European Union member states must deliver the promised allocations of 0.7% of GNI as ODA by 2015.

However, even the most optimistic forecasts for the levels of aid which will be reached through traditional ODA by 2015 indicate a significant funding gap for meeting the MDGs. On HIV/AIDS there remains an $8.1bn funding gap for 2007 alone.

The problem is exacerbated by the fact that even the money that is provided does not always advance the MDGs since aid payments are highly volatile, budgets are often set to meet short-term domestic political priorities rather than long-term development, some aid comes with economic conditions attached and donors continue to provide poor quality information to recipient countries.

> *I continue to strongly support the exploration of innovative mechanisms for financing for development… the funding gap we are facing reminds us all of the crucial need for additional flows of development finance. Closing this gap is essential if we are to alleviate extreme poverty, fight diseases and achieve the other development targets.*
>
> Ban Ki-moon, UN Secretary General

3 Innovative finance – a new way forward

With the overseas aid budget stretched to its limit in meeting the 0.7% target and with ever-increasing demands on its resources, from fighting terrorism to post-war construction activity, it is clear that the extra long-term funds required to pay for the MDGs must be sourced from elsewhere. New sources of finance can supplement development budgets and enhance the possibility of meeting the MDGs. Innovative financing of development is not only a means of generating much-needed money, it is also a way of addressing quantity, quality and predictability issues simultaneously. Within a few years it has moved from the fringe to the mainstream with politicians both in poor nations and in wealthy countries recognising its potential.

Recently two innovative schemes have been introduced – the International Finance Facility for Immunisation (IFFIm) and UNITAID, the international drug purchase facility, principally funded by aviation solidarity levies. These two initiatives have produced $1.3 billion between them and are making a significant contribution to global health. However, each has its own particular limitations and further complementary schemes need to be introduced at the earliest possible time.

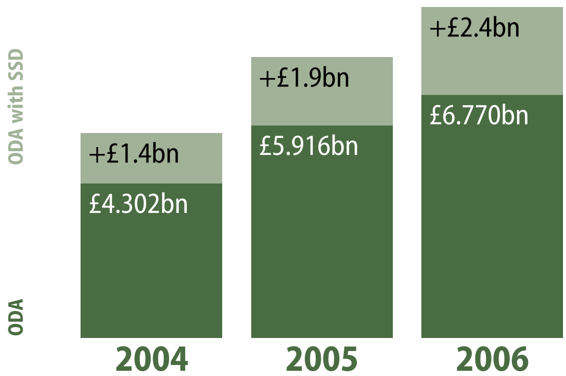
4 New money

The proposal examined by this Inquiry is for the introduction of a 0.005% stamp duty on all sterling foreign exchange transactions worldwide to be ring-fenced as additional revenue for international development. It would be implemented in the usual way by announcement in a budget and enactment through a finance bill.

The foreign exchange market is one of the last untaxed areas of business in the world. It trades globally around the clock with more than $3 trillion changing hands every day. The fact that these massive trades are not subject to any tax stands in stark contrast to the volume of wealth netted by market participants such as banks, hedge funds, traders and brokers. Moreover, profits in the banking sector itself continue to rise with a 21.9% increase in profits for 2006 amounting to, for the top 1,000 banks, a pre-tax total of $786.3bn.

The Sterling Stamp Duty (SSD) proposal for a 0.005% levy is 100 times smaller than the UK's existing stamp duty on shares. The proposed 0.005% rate has been explicitly set at a level that would not cause any disruptions to the market. Evidence suggests that this 0.005% rate would raise $4.98bn (or £2.44bn) in its first year, if implemented now, with the potential for greater income year on year. The market is growing at an exponential rate. Recent figures from the Bank for International Settlements show a 71% increase over the last three years. The projected revenue from the SSD would equate to an increase of approximately 30–40% on ODA, or up to 50% if debt relief is excluded. It appears that a co-ordinated transaction tax levied on the four major world currencies – dollar, euro, yen and sterling – would yield revenue of $33.41bn (£16.36bn) annually.

Graph showing estimates of value added by SSD to UK ODA



The SSD revenue generated has been calculated using the methodology employed by Professor Rodney Schmidt in *The Currency Transaction Tax: Rate and Revenue Estimates*, September 2007.

5 The duty would be easy to implement

Strong evidence has been put forward to indicate that the levy would be relatively simple to implement, thanks to a combination of the extensive computerisation of the foreign exchange industry and the regulatory systems put in place to ensure financial stability. The technology and institutions now in place make it possible to identify and tax gross foreign exchange payments, whichever financial instrument is used to define the trade, wherever the parties to the trade are located, and wherever the payments are made. One small foreign exchange brokerage, INTL Global Currencies, ran a week-long SSD pilot scheme in May 2007. It imposed a 0.005% levy on all currency transactions, raising several thousand pounds and encountering no technical issues.

> *'Our business is totally electronic and automated. I'm not sure where the idea of this being technically complicated has come from. To collect the revenue we literally pressed a button – it was that simple.'*
>
> Philip Smith, Director of INTL Global Currencies

6 Objections can be overcome

The City of London and foreign exchange industry will resist the proposal. This is not surprising. For self-interested but wholly understandable reasons bankers, fund managers and lobbyists for the financial services industry will argue vociferously against any new tax laid at their door. Detailed academic research submitted to this Inquiry suggests that many, if not all, of their objections can be met and that:

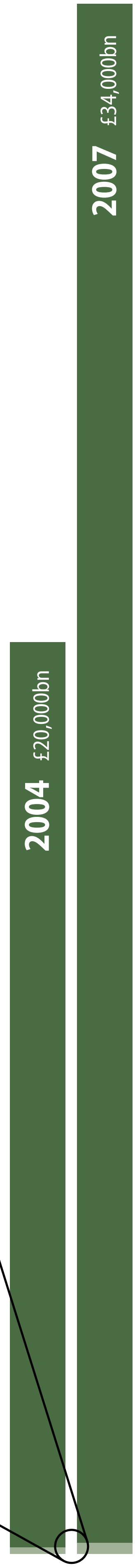
- London will continue to thrive as a leading financial centre as its status depends on its skills base and invisible networks, which would not be threatened by the introduction of a very small transaction charge on one area of its many diverse activities.
- The tax cannot be avoided by moving the trade outside of the UK since the stamp duty applies to all sterling transactions wherever they are traded in the world, not to all currencies traded in the UK.
- Foreign exchange houses will absorb or pass on the duty as a small extra element to existing transaction costs.
- Computerisation and an automated electronic market make it difficult and costly to disguise trades.
- Sterling transactions will be identifiable and taxable even if they are in the form of derivatives or options.
- Banks and other institutions have a strong record of adapting to regulations and taxes imposed on them and a duty of this size would not impede or distort financial markets.
- Share dealing in the City has expanded despite a 0.5% stamp duty on stock transactions.

Graph showing how little the SSD would skim from the vast forex market

The SSD revenue generated has been calculated using the methodology employed by Professor Rodney Schmidt in *The Currency Transaction Tax: Rate and Revenue Estimates*, September 2007. Not to scale.

2004 Total sterling traded £20,000bn
SSD would have generated £1.4bn

2007 Total sterling traded £34,000bn
SSD would have generated £2.4bn



> *It is highly implausible that a very small tax of 0.005% will make a dent in London's status as the world's financial centre.*

Ha-Joon Chang, Reader in the Political Economy of Development, Cambridge University

The UK is without doubt a substantial leader on development policy, not only in the EU but worldwide, so the implementation of such a tax by the UK would be very closely observed.

Susan McAdams, Multilateral and Innovative Financing Director, World Bank

Conclusion

The evidence collected by this Inquiry suggests that a Sterling Stamp Duty, set at the appropriate level, could provide considerable sums, at little cost, towards meeting the Millennium Development Goals. Since the proposed levy depends on currency trading for revenues, it also provides an opportunity for the City of London to show that in the wake of record profits, huge bonuses and concerns over the negative impacts of globalisation, it is making a direct quantifiable contribution to international aid and poverty relief.

The Government should undertake open and careful research into the Sterling Stamp Duty as an innovative means of meeting its MDG commitments. It should carefully avoid 'in principle' objections to new taxation instruments to increase development revenue and give particular attention to the experiences of other countries that have implemented similar levies. The potential for leadership by the UK in this area is considerable. But imagination and strength of purpose will be essential if we are to make the most of our privilege and fulfil our promises to the poorest inhabitants of our shared planet.

RECOMMENDATIONS

In light of the conclusions reached by this Inquiry and presented in this Report, the All Party Parliamentary Group on Debt, Aid and Trade recommend that the UK Government:

1. **Undertake rigorous research in an open and transparent manner into the implementation of a 0.005% stamp duty on all sterling foreign exchange transactions, to provide additional revenue to help bridge the significant funding gap required to meet the Millennium Development Goals.**
2. **Encourage other OECD nations, particularly European countries, to strongly consider implementing a similar levy on their own currencies with the aim of multiplying and internationalising the effort to create a new, predictable, long-term stream of finance to help meet the Millennium Development Goals.**
3. **Work with other like-minded countries to research, develop and urgently implement other new sources of development finance.**
4. **Ensure that the UK and any other countries that implement currency transaction development levies adhere to the principle that this finance is additional to aid already committed to reach the 0.7% target of GNI for ODA.**
5. **Participate in the International Taskforce for the investigation of a Currency Transaction Development Levy agreed at the Leading Group Conferences in Oslo and Seoul.**
6. **Play a more active role within the Leading Group on Solidarity Levies to Fund Development and seriously consider hosting a forthcoming conference of the Leading Group.**

Finally, we urge Ministers to encourage HMT to give serious consideration to the Sterling Stamp Duty proposal, especially since it is now so widely accepted by finance experts as entirely feasible.

Introduction

The All Party Parliamentary Group for Debt, Aid and Trade is a cross-party group of MPs and Peers which fosters parliamentary interest and support for greater debt relief, increased international aid delivered in a more efficient manner, and the promotion of an equitable trading system for developing countries. In particular we are extremely concerned that we are profoundly off track to meet the various 2015 targets of the Millennium Development Goals with dire consequences for the world's poorest people, most especially on the African sub-continent.

This Inquiry was set up to investigate the funding gap between traditional development assistance and what is required to pay for the MDGs. We wanted to look at innovative finance which is now firmly on the mainstream political agenda with initiatives recently launched such as the UK-led International Finance Facility for Immunisation and the French-led UNITAID. The Inquiry particularly focused on a prospective financing mechanism which has been the subject of substantial debate over some years both here in the UK and abroad, namely a Sterling Stamp Duty (SSD) or currency transaction tax. This would be a small duty that could be applied to the world's financial institutions on a section of their business that has to date remained exempt. If levied, it would generate a significant new income stream that could provide essentials such as clean water and medicines to those living without basic amenities. If such a financing initiative were to come into being it is clear that it would be of enormous benefit to the developing world.

The aim of the Report was to seek the views of academics, NGOs, finance experts and UK and foreign governments through both written submissions and oral evidence. All the contributors are eminent people in their fields and we would like to place on record our sincere thanks for the time they gave to assist our inquiries. We believe that their evidence provides a unique insight into both the feasibility and desirability of a Sterling Stamp Duty as an immediate means to bolster UK development spending. This Report addresses key questions about the SSD proposal, including its feasibility, answering objections, addressing UK implementation, as well whether, by adopting it, the UK could provide a leadership role to like-minded countries committed to achieving the Millennium Development Goals.

To be effective a Sterling Stamp Duty would have to be easily and inexpensively implemented, capture the vast majority of sterling transactions around the world, and be set at a level that would not lead to avoidance or cause any adverse effect to UK trade or the City of London. On the balance of the evidence provided to this Inquiry we believe that it passes these tests and should be actively considered by the UK Government. The need is urgent and we as political representatives should redouble our efforts at this mid point of the MDG timetable.

Finally this Report would not have been possible without the enormous work from not only our Report's author, Phil Thornton, but also the advice and support from David Hillman and Claudia Waller of Stamp Out Poverty and the contributions from our Group volunteers, Ulviyya Hasanzade, Paul Kirby and Janina Sanders – our thanks to all of them.

Ann McKechin MP, Chair of the All Party Parliamentary Group on Debt, Aid and Trade

1 Current levels of development aid are not sufficient

> *Every world leader, every international body, almost every single country signed a historic declaration for the new millennium, pledging to set and then to meet by 2015 eight development goals… But seven years on it is already clear that our pace is too slow; our direction too uncertain; our vision at risk. If 30,000 children died needlessly and avoidably every day in America or Britain we would call it an emergency… It is time to call it what it is: a development emergency which needs emergency action.*
>
> Prime Minister Gordon Brown[1]

In September 2000, 147 heads of State and Government, and 191 nations in total, adopted the Millennium Declaration, which contained a set of inter-connected and mutually reinforcing development goals[2]. The Millennium Development Goals (MDGs), as they became known, are eight targets for far-reaching improvement to the lives of the world's most disadvantaged people, from halving extreme poverty to halting the spread of HIV/AIDS and providing universal primary education. It is becoming increasingly clear, however, that very few (if any) of the Goals and their attendant targets will be met by the deadline date of 2015.

1 Gordon Brown – Speech to the United Nations in New York, 31 July 2007. Transcript available at: www.number-10.gov.uk/output/Page12755.asp

2 United Nations General Assembly – Resolution A/55/2, United Nations Millennium Declaration, 8 September 2000. Available at: www.un.org/millennium/declaration/ares552e.htm

1.1 The world is failing to achieve the Millennium Development Goals

In the UN's Millennium Development Goals Report 2007, UN General Secretary Ban Ki-Moon presented a stark prognosis: 'So far, our collective record is mixed…there have been some gains…[but] much remains to be done. There is a clear need for political leaders to take urgent and concerted action, or many millions of people will not realise the basic promises of the MDGs in their lives.'[3]

A snapshot of the facts illustrates well the distressing situation of those most in need seven years after the turn of the millennium:

- In Sub-Saharan Africa, the absolute number of people without access to sanitation actually increased between 1990 and 2004. Sanitation and hygiene shortfalls continue to contribute to 1.5 million annual deaths from diarrhoeal diseases. If trends in sanitation since 1990 continue, the world will miss the MDG target by almost 600 million people;[4]
- Despite expanding efforts to provide treatment for those living with HIV and AIDS in the developing world, only 28% of the estimated 7.1 million people in need are receiving anti-retroviral treatment;[5]
- Sub-Saharan Africa is not on track to achieve any of the Goals. Although there have been major gains in several areas and some of the Goals remain achievable in many African nations, even the best governed countries on the continent are not making sufficient progress in reducing extreme poverty in its many forms.[6]

Currently only one of the Goals – to halve the number of people in extreme poverty – is on course to be met.[7] Even here, the achievement is largely driven by the rapid industrialisation and urbanisation of China and India. Tellingly, Africa, which has been the focus of so much government policy and publicity, is almost certain to miss the target.

The MDGs are not over-ambitious targets. They are simply a rolling out of basic standards that we, in richer countries, take for granted. Before the 2005 G8 summit, Oxfam warned that if current trends continued and the world failed to meet the MDGs, by 2015:

- 45 million more children will have died;
- 53 million more people in Sub-Saharan Africa will not have access to proper sanitation; and
- 247 million more people will still be living on less than $1 a day

than would have been the case, had the targets been achieved.[8]

Two years on, it is clear that many of the promises made at Gleneagles have not been honoured. G8 aid to poor countries has actually fallen and the spending targets set in 2005 could be missed by $30 billion. Even the UK, one of the few G8 countries to increase its aid spending in the last two years, is likely to miss its promised spending by $1.6 billion.[9]

Moreover, Oxfam's assessment does not account for the development implications of a further worsening of the planet's environment. The 2006 report on climate change by Sir Nicholas Stern shows that poor countries may well suffer a loss in excess of 10% of their Gross National Income (GNI)

3 United Nations – The Millennium Development Goals Report 2007 (New York: United Nations, 2007) p3. Available at www.un.org/millenniumgoals/pdf/mdg2007.pdf

4 Ibid, p25–26

5 Ibid, p19

6 Ibid.

7 Ibid, p7

8 Oxfam International – *Paying the Price: Why Rich Countries Must Invest Now in a War on Poverty* (Oxford: Oxfam International, 2005), p6. Available at www.oxfam.org.uk/resources/policy/debt_aid/downloads/mdgs_price.pdf

9 Oxfam International – 'The World Is Still Waiting: Broken G8 Promises Are Costing Millions of Lives', Oxfam Briefing Paper 103, May 2007, p8. Available at www.oxfam.org.uk/resources/policy/debt_aid/downloads/bp103_g8.pdf. Figures for the shortfall exclude debt relief.

if no action is taken to curb global warming.[10] Furthermore, since 'adaptation [to climate change] will cost tens of billions of dollars a year in developing countries alone, and will put still further pressure on already scarce resources,'[11] it is clear that the 0.7% target, which was set in 1970 prior to current awareness of the impact of climate change, does not provide for these extra demands. In other words, even if the 0.7% target was reached by all OECD countries, this would still not be enough to meet the MDGs and mitigate the development impacts of climate change.

There is a widespread consensus on the acute need for extra funding to tackle problems of global poverty, disease and hygiene. Without fresh finances the world will fail to meet the Millennium Development Goals and millions of lives that could have been saved will be lost.

Box 1

The Millennium Development Goals

1 Eradicate extreme poverty and hunger

- Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day
- Halve, between 1990 and 2015, the proportion of people who suffer from hunger

2 Ensure access to primary schooling for all children

- Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling

3 Promote gender equality and empower women

- Eliminate gender disparity in primary and secondary education, preferably by 2005, and to all levels of education no later than 2015

4 Reduce child mortality

- Reduce by two-thirds, between 1990 and 2015, the number of children 5 years old or younger who die from preventable illnesses

5 Improve maternal health

- Reduce by three-quarters, between 1990 and 2015, the number of women who die giving birth

6 Combat HIV/AIDS, malaria and other diseases

- Have halted by 2015 and begun to reverse the spread of HIV/AIDS
- Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases

7 Ensure environmental sustainability

- Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources
- Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation
- By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers

8 Develop a global partnership for development

Targets include:

- In co-operation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries
- In co-operation with the private sector, make available the benefits of new technologies, especially information and communications
- Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term

10 HM Treasury – *The Stern Review,* Report on the Economics of Climate Change, October 2006: Full Executive Summary, page ix. Available at www.hm-treasury.gov.uk/media/4/3/Executive_Summary.pdf

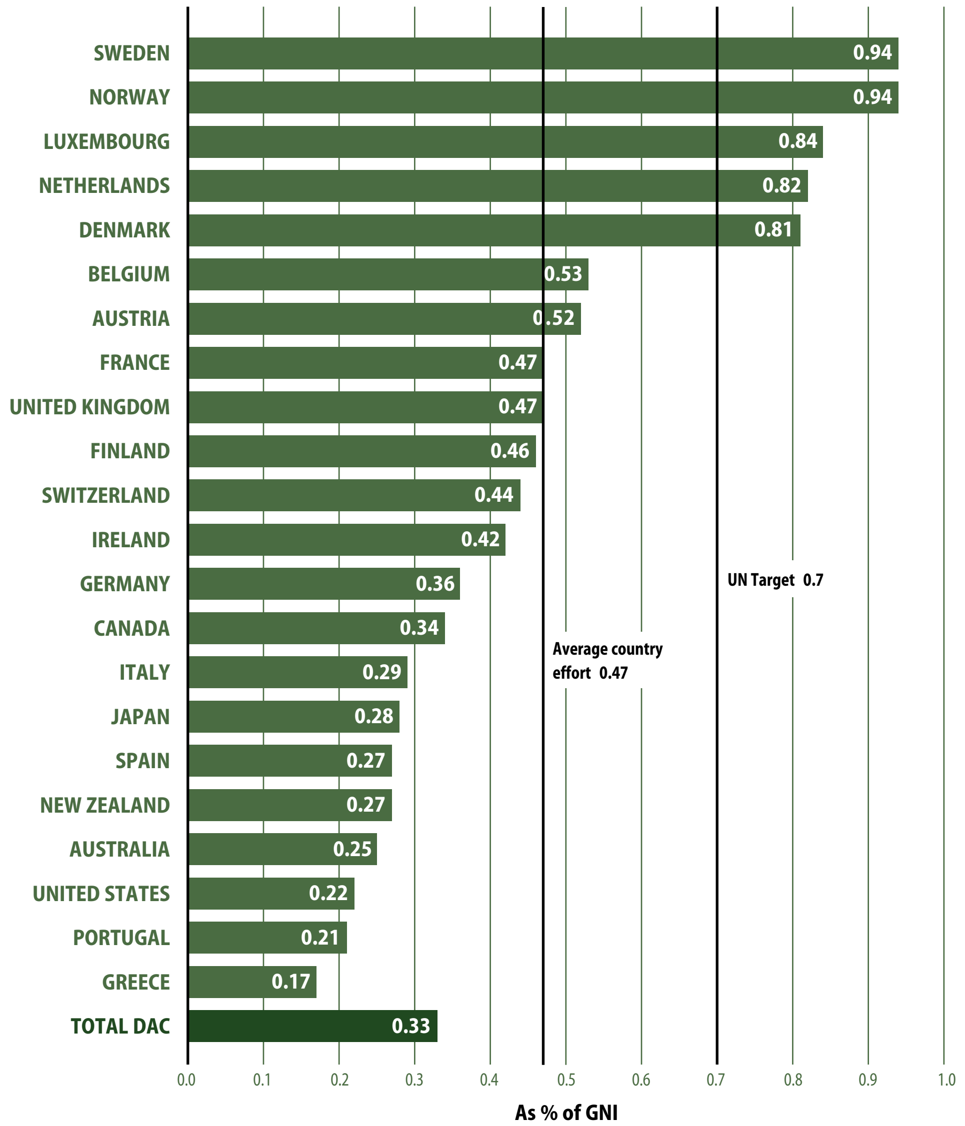
11 HM Treasury – *The Stern Review,* Report on the Economics of Climate Change, October 2006: Short Executive Summary, page vii. Available at www.hm-treasury.gov.uk/media/9/9/CLOSED_SHORT_executive_summary.pdf

1.2 More money is needed

This failure to meet the MDGs is the cumulative result of a range of different factors. International development is an inherently complex field, compounded by an endemic lack of co-ordination. Primarily, rich country governments, by not living up to the 0.7% aid commitment made in 1970, have failed to deliver the necessary volume of funds on the ground. It is clear that existing aid could be spent better in order to maximise its impact; the diversion of a significant proportion of those funds towards non-MDG related objectives reduces the finance which has been available to Least Developed Countries (LDCs) for poverty alleviation. Secondly, aid spending is often driven by the political priorities of the donor nations and tied to contracts and economic conditions that add extra costs onto the recipient country. Thirdly, aid is often not spent strategically enough, is not long-term and predictable and is subject to budget constraints. These challenges demonstrate that there is a need for a new form of long-term finance which will provide additional funding to fill these gaps.

1.2.1 AID VOLUME

Graph 1 Net ODA in 2005 as a percentage of GNI[12]



12 Adapted from Organisation for Economic Co-Operation and Development (OECD) – Final Official Development Assistance (ODA) Data for 2005, p8. Available at www.oecd.org/dataoecd/52/18/37790990.pdf

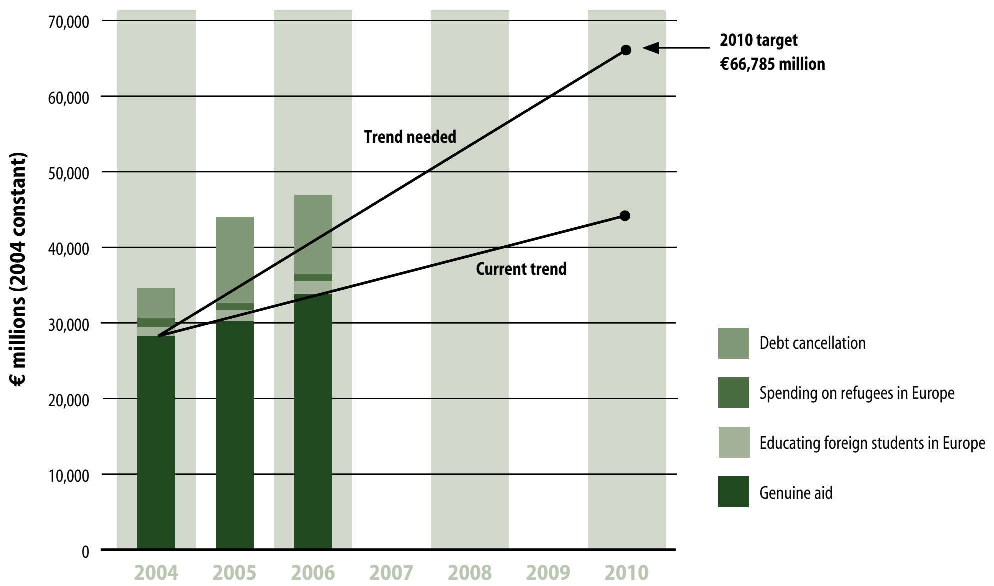
In 2005 rich countries gave only 0.33% of their combined GNI as aid, the same percentage as in 1992. Two years ago, at the Gleneagles Summit, the G8 committed to giving an additional $50bn per year in aid by 2010 including an additional $25bn for Africa.[13]

In their evidence the UK Aid Network (UKAN) noted that: 'Although this is clearly welcome, [even] if these pledges are delivered, aid will still only amount to 0.36% of rich countries' combined national income, not enough to meet the MDGs.'[14] UKAN called on donors to commit to the target, especially the US, Japan and Canada who have made no formal commitment to give 0.7% of GNI as aid and said that all donors should provide detailed annual timetables that guarantee annual aid increases.

The UK has made a commitment to hit this target. However, only reaching the 0.7% target in 2015 (or in the UK's case 2013) makes it highly unlikely that sufficient flows of aid will be delivered in time to meet the MDGs in the same year. Better plans for genuine aid increases need to be put in place. As Richard Manning, current chair of the Development Assistance Committee of the OECD has said: 'It is clear that leaving delivery to sudden and colossal increases in the last year or two would not be a sensible policy. (…) It seems highly unlikely that debt write-off to Africa will continue at the levels of the recent past. Other forms of aid will therefore need to rise very fast to compensate for this if the target is to be reached'.[15]

Aid from European governments has been gradually increasing since 2004. But if they are to meet their 2010 commitments, they need to at least double their aid budgets in real terms. However, as illustrated below, if current trends continue, it has been estimated that for poor countries there will be a significant shortfall compared with the amounts they had been promised.

Graph 2 Trends of EU aid[16]



13 G8 Gleneagles 2005 Policy Issues: Africa Summary. Available at www.g8.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1094235520151

14 Written evidence of UKAN to this Inquiry.

15 Quoted in CONCORD/EURODAD – *Hold The Applause! EU Governments Risk Breaking Aid Promises*, April 2007, p8. Available at www.eurodad.org/uploadedFiles/Whats_New/Reports/Hold_the_Applause.FINAL.pdf

16 Adapted from Ibid, p8.

In 2005, the UN Millennium Project estimated that global ODA would need to rise to $135bn in 2006 and $195bn in 2015 if all countries were to meet the Goals.[17] This increase would be equivalent to an average of 0.54% of developed countries' GNI by 2015. On HIV funding specifically, there remains an $8.1bn funding gap for 2007 despite recent increases in aid.[18] In his submission, Khalil Elouardighi, a UNITAID board member, said: 'Less than half of the resources needed to stay above water is made available. Out of the annual $22bn which UNAIDS estimates is necessary to control the AIDS pandemic, UNAIDS anticipates a $12bn annual funding gap.'[19]

Both the Treasury and the Department for International Development highlighted the UK as a country that is committed to reaching 0.7% ODA by 2013: 'The UK is pressing for a regular review of progress against the targets. Donors must be held to account. We must continue to make the case for increased aid, including how these additional resources can be spent.'[20]

But with average EU ODA at 0.33% of GNI, and even with UK ODA a degree higher at 0.56%, there is still a lot more money to find.

Debt relief is clearly a crucial element of securing economic justice and sufficient resources for poor countries as it usually provides predictable resources to fund healthcare, sanitation and education. However, the situation is compounded by the fact that ODA figures include debt relief, which means that the aid figure is overstated in the year that the debt was recorded, particularly if the debt was not being repaid.

In 2006, €11 billion counted by Europe as aid was in fact debt cancellation. Cancelling the debts of Iraq and Nigeria alone accounted for €8 billion of this figure.[21] The majority of these debts were export credit debts. Counting the cancellation of export credit debts as ODA is particularly unjust: Export Credit Agencies in rich countries aim to support domestic companies in doing business abroad, particularly in lucrative but risky developing country markets, by providing government-backed loans to cover economic and political risks.

Counting debt relief towards the 0.7% target effectively could mean that the value of the debt is being offset by a reduction in the aid that would otherwise be delivered in order to meet the target. Both increasing aid volumes *and* substantial debt cancellation are required to meet the MDGs. Indeed, as part of the 2002 Monterrey Consensus, donors have recognised the importance of 'ensuring that resources provided for debt relief do not detract from the aid resources intended to be available for developing countries'.[22]

Excluding debt relief, UK aid rose by more than 21% in 2006, to 0.38% of GNI.[23] This is a welcome increase, and exceeds the EU minimum target, but is only just over halfway towards the Government's commitment to reach 0.7% of GNI as aid by 2013. The UK has led the way by choosing not to include foreign student costs and refugee costs as ODA, but still continues to count debt relief towards the 0.7% target.

17 The UN Millennium Project – Report to the UN Secretary-General, *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals* (London: Earthscan, 2005) p250.
Available at www.unmillenniumproject.org/documents/MainReportComplete-lowres.pdf

18 Ibid.

19 Written evidence of Khalil Elouardighi to this Inquiry.

20 Joint Treasury/DfID written evidence to this Inquiry.

21 CONCORD/EURODAD – *Hold The Applause!* p9

22 Quoted in Ibid.

23 Ibid, p16

1.2.2 THE NEED TO IMPROVE THE EFFECTIVENESS OF AID

Aid money should be used to reduce poverty and inequality. But aid payments often reflect the political priorities of donor countries. This can include domestic political pressure to cut spending budgets, or the desire to use aid money to meet overseas political priorities. Experts have noted that a 'strategic interest motivation' often exists for some countries, citing additional financing by the US for Pakistan in the wake of the 9/11 terrorist attacks.[24] The same phenomenon can be found in US funding for Egypt and Iraq following the Iraq war. Iraq received 5.3% of the 2007 allocation by the government agency, USAID, while Egypt received 5.1% and Pakistan 4.5%. This contrasts with 0.1% for Benin and 0.2% for Burkina Faso, two of the world's poorest countries.[25]

The World Bank's 2006 Global Monitoring Report identified a similar pattern when it argued that 'aid should be targeted to countries with poorer populations and governments committed to poverty reduction' and noted that 'other factors still determine a large share of aid disbursements. For example, over 60% of the increase in ODA between 2001 and 2004 was directed to three countries – Afghanistan, the Democratic Republic of the Congo, and Iraq, although these three countries collectively account for less than 3% of the poor people in developing countries.'[26]

In 2004, about 43% of European Commission development assistance was allocated to LDCs, increasing marginally in 2005 to 46%. Instead of addressing the Commission's stated poverty focus, all too often, instead, allocations are the result of protracted political negotiations in which each member state has its own vested interest. For instance in 2005, almost 23% of the EC ODA stayed in Europe or in the Mediterranean area.[27]

One tends to assume that the main objective of aid is poverty reduction. Although this is frequently the case, many European governments and the European Commission itself have been increasingly inclined to allocate resources based on European concerns on security and migration issues. As European NGOs have argued, if aid were indeed focused on poverty reduction, one would expect an increasing volume of it to go to Sub-Saharan Africa, the poorest region in the world. Official EU ODA figures for Africa did rise by €3.2 billion from 2004 to 2005. But, as with many other issues of aid, headline figures obscure less laudatory details. In reality, once debt relief is excluded, European aid volumes to Africa have remained static since 2004. The share of European aid going to Africa is in fact dropping, from 41% in 2004 to 37% in 2005.[28]

24 Oral evidence of Dr Ha-Joon Chang to this Inquiry.

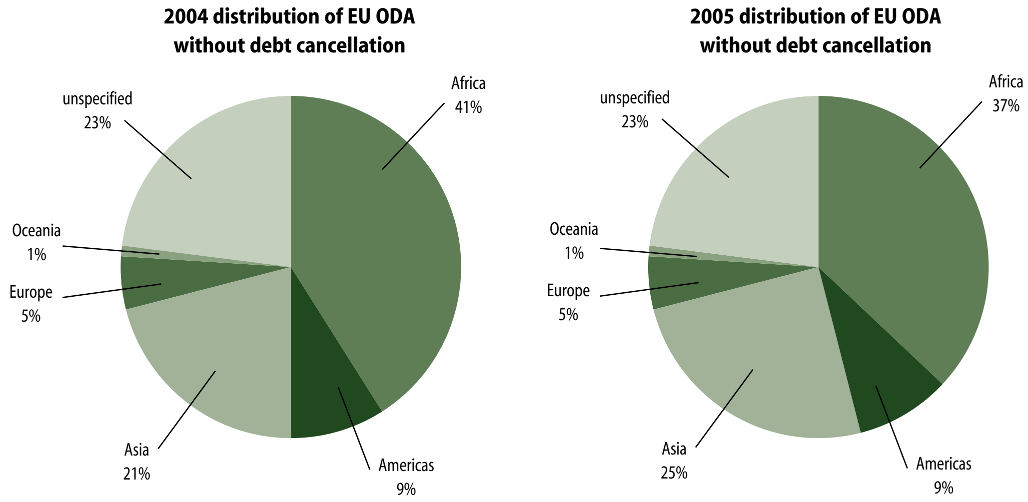
25 USAID Country Allocation Summary for Financial Year 2007.
Available at www.usaid.gov/policy/budget/cbj2007/summtabs/st_5abcd.pdf

26 World Bank – Global Monitoring Report 2006, *Millennium Development Goals: Strengthening Mutual Accountability, Aid, Trade, and Governance* (Washington DC: World Bank) p83. Available at http://siteresources.worldbank.org/INTGLOBALMONITORING2006/Resources/2186625-1145565069381/GMR06Complete.pdf

27 CONCORD/EURODAD – *Hold The Applause!* p45

28 Ibid, pg.12. These figures exclude debt relief, as shown in Graph 3.

Graph 3 Shares of EU aid by destination[29]



Box 2

Extract from oral evidence of Professor Joseph Stiglitz

'Until the end of the Cold War a very large fraction of aid money was directed towards the Cold War, not development. It was called development assistance but it really wasn't…who gets it and how it is spent is determined not by issues of development effectiveness but by political concerns. So it is not surprising when your focus is not on development that you don't get development. So to criticise aid for not getting development when that was not what it was designed for seems to be wrong.

…And there's absolutely no doubt that much aid that has been spent in the past has not been well spent. But that's true in any programme in the public or private sector. If you looked at how General Motors spent its investment and then you concluded from that that we shouldn't make cars…nobody would say that we should no longer make automobiles…So I think that one shouldn't single out foreign aid as an example where money is sometimes not well spent – I think this is true for every sector of the economy.

Our ability to spend development assistance well has increased. I think we know more about aid effectiveness and how to deliver aid than, say, 20 years ago.'

1.3 The requirement for predictable funding

We have seen that current ODA is not enough to achieve the MDGs; that only a portion is directed specifically towards meeting those Goals; and that governments often fail to live up to their pledges to provide more money. However, even if governments were to address these issues, there would still not be enough funding. The current system of decision making about both quantity and quality of aid is too open to political demands and timetables to provide the long-term, predictable and sustainable assistance that development academics, Southern governments and NGOs believe is vital.

In its request for submissions, the Group asked whether current disbursement of aid met requirements of predictable, sustainable and long-term aid. The answer from the vast majority of respondents was a resounding 'no'.

29 Adapted from Ibid.

In his oral evidence Professor Joseph Stiglitz, said: 'When, for one reason or another, budget revenues go down, development is one of the more vulnerable areas. Since it so important to have stability of these revenues for development purposes, it is natural to try to find sources of revenue that have more stability.'

> *If aid is to be effective in meeting the MDGs, it must support partner countries to deliver long-term and sustainable development strategies. In order for this to happen, partner countries must be able to plan ahead.*
>
> UK Aid Network – written submission

As UKAN's comment suggests, developing countries need to be able to set their own priorities and strategies, allocate budgets and be confident that they can fund running costs such as salaries for the lifetime of certain projects. The problem is that aid is not disbursed in a way that meets these needs.

Firstly, aid is highly volatile. A recent study by the International Monetary Fund (IMF) showed aid flows were more volatile than fiscal revenue and that the higher the aid dependency of a country, the higher the aid volatility.[30] This problem is compounded by the fact that different countries set aid budgets over different timescales, and in many cases these timeframes are too short to help recipient countries achieve strategic objectives. Many donor agencies and countries are unable or unwilling to provide multi-year aid commitments that would allow recipient countries to plan ahead. In terms of treating HIV/AIDS, the longest period that donors are willing to make financial commitments for was five years. As one witness put it: 'Most developing countries feel that they cannot attempt to overhaul their health system as part of achieving the UN objective of universal access to AIDS treatment by 2010 if the aid offered for it could dry up after only five years. Ten to 15 years seems to be the bare minimum duration that enables them to attempt such challenges.'[31]

> *Countries significantly dependent on aid…need to be able to plan over at least the medium term (five years) in order to implement the strategies they have made. Currently aid is focused on the short-term, with some donors planning over just a one-year cycle.*
>
> Save the Children – written submission

The relationship between donor and recipient countries needs to be significantly improved: a recent survey for the OECD Development Assistance Committee (DAC) showed that donors often fail to provide information needed for aid to be included in budgets. It found that there was a consistent gap between what donors promise and what they deliver and that a third of aid was not disbursed in the financial year for which it was promised.[32] The fact that there is also little transparency about how donors make their decisions on aid spending makes it hard for recipient countries to plan ahead.

30 Bulíř, A and Hamann, A – 'Volatility of Development Aid: From the Frying Pan into the Fire?', IMF Working Paper WP/06/65, 2006. Available at www.imf.org/external/pubs/ft/wp/2006/wp0665.pdf

31 Written evidence of Khalil Elouardighi to this Inquiry.

32 Organisation for Economic Co-Operation and Development (OECD) – Development Co-operation Report 2006: Summary, February 2007. Available at http://masetto.sourceoecd.org/pdf/dac06/InsertDCR2006.pdf

I have quite a few friends in the NGO community and they say you have to write your proposal according to the buzzword of the moment, which has a very distorting effect. A lot of proposals are not seen through.

Ha-Joon Chang – oral evidence

Most aid still comes in the form of specific projects that do not cover running costs such as salaries for teachers and doctors. General or sectoral budget support can be an effective means of financing such running costs but only 5% of total ODA is directed towards general budget support, with only 15% directed sectorally.[33]

Achieving the MDGs requires both higher and more stable ODA flows. The current systems seem ill-equipped to deliver either.

Stephen Spratt, a director at the New Economics Foundation – written submission

The overwhelming conclusion is that official aid payments are not only too low but those sums that are disbursed are not predictable, sustainable or long-term enough to help recipient countries to embark on major schemes to improve the health, education and poverty of their citizens. There is consequently an urgent need for supplementary forms of finance that are long-term and predictable.

Conclusion

This section has shown that for many reasons, levels of ODA are not sufficient to fund the MDGs. This is true for regional blocs such as the EU, multinational organisations such as the G8 and individual member states. While the UK is a moderately high contributor in terms of aid volume it is nonetheless subject to the same aid failings as most other states and has not yet met its long overdue pledge to give 0.7% GNI.

Estimates of required MDG expenditures – most comprehensively presented by the UN's Millennium Project (UNMP) in 2005 – explicitly assume that expenditure on the MDGs will have to increase continually until 2015 for the Goals to be met. However, they also point out that, historically, only about 25% of ODA has been targeted towards the different aspects of the MDGs. Consequently, regardless of increased commitments of ODA – even if they were to be fulfilled – we face a substantial and rising shortfall of ODA dedicated to meeting the MDGs.[34]

Developed countries must deliver fully on longstanding commitments to achieve the official development assistance (ODA) target of 0.7% of gross national income (GNI) by 2015. It requires, in particular, the Group of Eight (G8) industrialised nations to live up to their 2005 pledge to double aid to Africa by 2010 and European Union Member States to allocate 0.7% of GNI to ODA by 2015.

To see addressing the plight of the world's most disadvantaged people through an altruistic lens alone risks seeing only a partial and distorted picture. There is more at stake than saving lives and improving

33 Ibid, p7

34 Written submission of Dr Stephen Spratt to this Inquiry.

life opportunities, however vital this may be. Addressing poverty in poorer countries is a strategic investment in a healthier, more secure, stable and prosperous world. Comparisons have been made to the US adoption of the Marshall plan after the 2nd World War. Following a traumatic 5 years of war in Europe, the US paid 1% of its Gross Domestic Product (some $13 billion in economic and technical assistance over 4 years from 1947) towards European reconstruction and development. This brought stability and security, a major political ally on the doorstep of the Soviet Union and economically, as countries got back on their feet, substantial markets for US exports.

This APPG affirms its support for the UK Government's commitment to reaching 0.7% of GNI by 2013 and emphasises this Inquiry into new and additional sources of finance should in no way undermine the absolute importance of this 0.7% commitment being met by all OECD countries.

> *'Let me say to business: you know better than anyone that in the long run you simply cannot succeed in places where the roads are impassable, where people have no access to markets, where employees are under-educated or under-fed, where the rule of law is poorly established or poorly respected. Not only does business have the technology, the skills, the expertise for wealth and job creation that if fully mobilised for global purpose will help meet our goals, it is also in your best business interest to help poor countries develop.'*
>
> Gordon Brown – speech to the United Nations, 31 July 2007

2 Innovative solutions to help bridge the aid funding gap

> *I continue to strongly support the exploration of innovative mechanisms for financing for development … the funding gap we are facing reminds us all of the crucial need for additional flows of development finance. Closing this gap is essential if we are to alleviate extreme poverty, fight diseases and achieve the other development targets.*

UN Secretary-General Ban Ki-moon[35]

Innovative finance has never been more firmly on the political agenda than now. In the last year alone we have seen two breakthroughs in new ways to fund development. While varying in design, both are novel financing schemes able to raise predictable flows of revenue that can be disbursed towards relief of distress and disease. The International Finance Facility for Immunisation (IFFIm), a UK-led initiative, is a borrowing mechanism, using Government pledges of aid payments to raise money on the capital markets in order to 'front-load' aid to developing countries. UNITAID, a French-led initiative, is a taxation mechanism, imposing a levy on a particular type of economic transaction to raise long-term funds. UNITAID is principally funded by a variety of aviation duties, levied nationally, then pooled and disbursed internationally to fund a drug purchasing facility that provides HIV/AIDS, TB and malaria treatments for people in developing countries who otherwise could not afford them.

Until very recently such schemes existed only in theoretical models. After great efforts by lead governments, IFFIm and UNITAID are now operational and may serve as important precedents for a new kind of funding that is both long-term and predictable, and necessary if we are to go the extra distance required to meet the MDGs.

35 Ban Ki-moon – Message to Seoul conference of the Leading Group on Solidarity Levies to Fund Development, 4 Sept 2007. Available at: www.un.org/News/Press/docs/2007/sgsm11139.doc.htm

2.1 International Finance Facility for Immunisation (IFFIm)

IFFIm was designed to accelerate the availability of funds to be used for health and immunisation programmes through the GAVI Alliance in 70 of the poorest countries around the world. By investing the majority of resources up front ('front-loading'), an anticipated IFFIm investment of US$4 billion is 'expected to help prevent five million child deaths between 2006 and 2015, and more than five million future adult deaths by protecting more than 500 million children with vaccination programmes against measles, tetanus, and yellow fever'.[36]

IFFIm's financial base consists of legally binding grants from its sovereign sponsors – France, Italy, Norway, Spain, Sweden, the United Kingdom and South Africa. By signing the grant agreements, these countries have agreed to pay these obligations in a specified schedule of payments over a period of between 5 and 20 years. The UK is the largest donor with £1.38bn pledged over 20 years. Initial IFFIm revenue of $1bn has been distributed by the GAVI Alliance during 2007 for funding immunisation programmes.

Box 3

The Leading Group on Solidarity Levies to Fund International Development

The Leading Group emerged from a growing realisation that existing funding for international development was insufficient to provide the means by which the MDGs could be fully met. Former French President Jacques Chirac set up a Special Commission to study new ways of creating aid finance. The outcome was the Action Against Hunger and Poverty (AAHP) report launched in September 2004. The following year 67 Governments signed the Leading Group declaration at the UN affirming their commitment to supplement traditional aid through innovative solidarity levies.

The inaugural international conference of the Leading Group, hosted by President Chirac and former UN Secretary General Kofi Annan in Paris in February 2006, was attended by over 70 Ministers. Less than two years after the publication of the AAHP report the aviation solidarity levy to fund the international drug purchase facility, UNITAID, was announced. With France, Norway, Chile, Brazil and the UK emerging as core members of the Leading Group, a second conference was held in Brasilia in July 2006 and UNITAID was launched two months later.

By the time the Leading Group held its 3rd international conference in Norway in February 2007, two innovative funding schemes were in place (IFFIm had been launched by the UK Government shortly after UNITAID) and a number of other potential financing mechanisms were under discussion. The Norwegian Government, who had shown particular interest in a currency transaction development levy (CTDL), announced the setting up of an international CTDL taskforce to examine its potential for financing development. A further indication of the growing popularity of the Leading Group was the hosting of the 4th international conference by South Korea in September 2007.

36 IFFIm website. Available at www.iff-immunisation.org

2.2 UNITAID

UNITAID, a French-led initiative, is an international facility working for increased levels of treatment for those affected by HIV/AIDS, malaria and tuberculosis. Launched in September 2006, the scheme has 27 member countries and more than 80 recipient countries. Most participating nations fund their commitment through an aviation solidarity levy on air tickets. UNITAID expects to receive $320 million by the end of 2007,[37] which is set to rise as the number of people travelling by air increases. Rather than operating simply to purchase and distribute life-saving treatments, UNITAID's primary purpose is to play a significant role in reducing the costs of medicines by working with agencies such as the Clinton Foundation to negotiate with pharmaceutical manufacturers to lower drug prices.

Some of UNITAID's achievements after its first year of operation include the treatment of more than 120,000 HIV positive pregnant women and more than 180,000 children with tuberculosis; as well as lowering prices of paediatric antiretroviral drugs by 40%.

2.2.1 ASSESSMENT

While both IFFIm and UNITAID are making useful contributions, it is important to acknowledge their limitations. There is some logic in front-loading aid in the model of IFFIm – borrowing against future aid budgets in order to roll out a comprehensive vaccination package to save lives in the developing world immediately, but this mechanism is not necessarily suitable for wider use. While there remains the option for employing it again for future specific target-orientated projects, it is by no means a comprehensive solution to plugging the funding gap. Both Professor Joseph Stiglitz and Dr Ha-Joon Chang expressed strong reservations about borrowing against future aid spending to fund wider aid programmes, emphasising that any spending errors now would severely damage future aid distribution.[38] In terms of UNITAID, it is important to recognise that implementing a solidarity levy on the airline industry was intended to lead to *further solidarity levies* on other industries. It is not appropriate that the airline industry remains singled out for development levies and it is doubtful that revenues from such a source could be significantly expanded in the absence of similar duties on at least some other industries seen as benefiting from globalisation.

Box 4

UNITAID – an excellent model

UNITAID illustrates both an innovative form of raising development funds and, equally importantly, an innovative way of spending aid money. Its purpose is to increase the number of people with access to HIV/AIDS, TB and malaria treatments by reducing drug prices, transforming a situation of high cost drugs for the few to one of low cost drugs for the many. UNITAID has a stream-lined infrastructure and is housed in existing WHO offices to keep administrative costs down. It is funded primarily by aviation solidarity levies, with a number of its key supporters making this funding additional to traditional ODA commitments. Its success can be measured both quantitatively and qualitatively; its source of revenue is guaranteed, predictable and sustainable as the majority is linked to the steady growth in air travel. It also fits with the long-term structural spending required to develop, purchase and administer courses of drugs for these particular diseases. In this way UNITAID exemplifies important principles in innovative development financing; predictable, long-term and additional finance is key to meeting the MDGs.

37 UNITAID Budget. Available at www.unitaid.eu/unitaid-budget.html

38 Oral evidence of Professor Joseph Stiglitz and Dr Ha-Joon Chang to this Inquiry.

2.3 Advance Market Commitments (AMC) for Vaccines

As a model, the AMC has been created to provide an incentive to create vaccines where the market is insufficient to prompt investment by pharmaceutical companies. In February this year, five countries – Canada, Italy, Norway, Russia, the United Kingdom – and the Bill & Melinda Gates Foundation committed $1.5bn to launch the first Advance Market Commitment to help speed the development and availability of a vaccine to combat pneumococcal disease (a major cause of pneumonia and meningitis), which is expected to save the lives of 5.4 million children by 2030.[39]

Bound by legal agreements, donors agree to provide financial commitments to subsidise the purchase cost of new vaccines for a period of time, and vaccine manufacturers agree to meet criteria for vaccine effectiveness and to provide the vaccine at affordable prices. A pilot AMC has been designed for pneumococcal vaccines to demonstrate both the feasibility of the AMC mechanism and its impact on accelerating vaccine development, production scale-up, and introduction. Countries taking the lead on this include the UK, Italy and Canada.

However, it is questionable whether the AMC model is an eligible example of an innovative finance scheme because revenue derives from the general aid budget. Some critics have argued that it is simply a form of subsidy to pharmaceutical companies, with a lingering issue of where ownership of intellectual property ought to reside if the initiative is principally being paid for by public money. Whilst it is clear that the AMC model, like UNITAID and IFFIm, may provide significant early revenues for a health-related objective, it is equally clear that it is not an example of a long-term, predictable aid mechanism.

2.4 New development financing – the next step

Wider options for innovative development funding have been evolving for a number of years with various types of mechanisms – such as borrowing, taxation or voluntary contribution – being explored. Aviation has been widely studied in respect of financing development with the following tax options among those under consideration: air fuel, tickets, airports, emissions, air traffic and air corridors. In the end, implementing a small levy on air passenger tickets was chosen as the principal method of funding for UNITAID. Other possible ideas have included taxing CO_2, maritime traffic, the use of maritime channels, financial transactions, the transportation of hazardous materials, weapon exports and outer space.[40] The UN Food Programme, for instance, has recently investigated the possibility of a global lottery to help fund its operations.

Despite these new avenues, the proposal that has been studied the most over the last 30 years is that of a levy on the financial market, or areas of it, that have thus far remained exempt from taxation. Given the urgency of the need for new money for international development, the Group deemed it essential to look at proposals that have been sufficiently researched and are ready, political will permitting, to be implemented immediately. This Report now turns to the proposal for a Sterling Stamp Duty, which appeared to fit these criteria.

RECOMMENDATION

Work with other like-minded countries to research, develop and urgently implement other new sources of development finance.

39 Advance Market Commitments for Vaccines website. Available at www.vaccineamc.org/index.html

40 Oral evidence of Professor Joseph Stiglitz to this Inquiry.

3 The Sterling Stamp Duty

> *'The art of taxation [is] like plucking a goose so that they squawk the least – the idea is that a low tax leads to less squawking. The rate [you propose] is very small and it therefore wouldn't pay to avoid the tax.'*
>
> Professor Joseph Stiglitz, Professor of Economics at Columbia University and Nobel Laureate in Economics[41]

The key proposal examined by this Inquiry is for the introduction of a 0.005% stamp duty on all sterling foreign exchange transactions worldwide to be ring-fenced as additional revenue for international development. It would be implemented in the usual way by announcement in a budget and enactment through a finance bill.

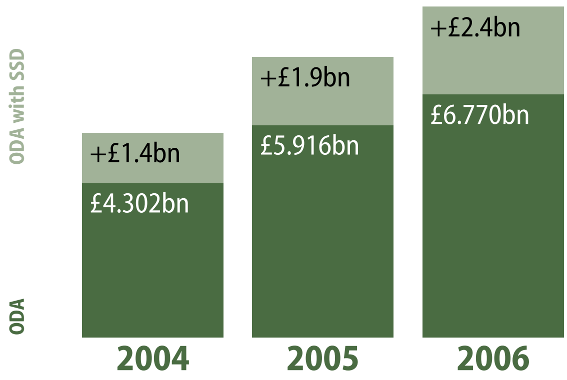
Evidence presented to this Inquiry, and using official statistics, suggests that the SSD has the potential to raise $4.98bn in its first year (£2.44bn at the current sterling/dollar exchange rate).[42] In the context of UK ODA for 2006 of £6.7 billion this would equate to an increase of 36% on current aid spending, and an even greater percentage on MDG-targeted aid. This is because, as we have seen, not all ODA is the kind of aid that would go towards meeting the MDGs. According to their latest figures, DfID's *aid* programme accounted for £4,923 million, and the overall DfID *programme* for £4,778 million, of expenditure in 2006/2007, once debt relief is excluded.[43] Using these figures, which better reflect spending on meeting the MDGs, an extra £2.44 billion would account for an increase of 49–51% on current *aid* spending – see Graph 4.

41 Oral evidence of Professor Joseph Stiglitz to this Inquiry.

42 Schmidt, R – *The Currency Transaction Tax: Rate and Revenue Estimates*, The North-South Institute, October 2007, submitted as part of the written evidence of Rodney Schmidt and using the most recent data on currency transactions from the Bank for International Settlements (see Footnote 49 below).

43 Department for International Development – Statistics on International Development 2007 Edition. Available at www.dfid.gov.uk/aboutdfid/statistics.asp

Graph 4 Showing estimates of value added by SSD to UK ODA



The SSD revenue generated has been calculated using the methodology employed by Professor Rodney Schmidt in *The Currency Transaction Tax: Rate and Revenue Estimates*, September 2007.

3.1 Unusual or otherwise

Taxes on financial transactions, such as taxes on share trading, bond trading, house purchases or bank debits, have a long history and most have operated successfully for many years and raised substantial amounts of revenue with no apparent negative impact on the market. In the UK, for example, a stamp duty on share transactions generated in the region of £4 billion in the last financial year.[44] Despite having this 0.5% (50 basis points) stamp duty on share transactions, the UK continues to be one of the top financial centres and the London Stock Exchange is one of the premier exchanges in the world.

In fact all of the G10 countries except Canada have levied financial transaction taxes (FTTs) at some time. Of these, the United States,[45] UK, France, Belgium and Switzerland have existing FTT regimes. The other G10 members have (relatively recently) dismantled the FTTs they had: Japan (1999), Italy (1998), Sweden and Germany (1991) and the Netherlands (1990). However, while there has been some movement towards the removal or reduction of transaction taxes, this is counterbalanced by recently imposed FTT regimes in India (2004), Peru (2003), Argentina and Colombia (2000), Ecuador (1999), Greece (1998), Finland (1997), Brazil (1997). In fact, Greece doubled its transaction tax on share trading in 1999.

> *‘These taxes raise between 5% and 20% of the total tax revenue in many of these Latin American countries. That’s a substantial amount of money and in the case of Brazil this tax is explicitly used to target development expenditure.’*
>
> Sony Kapoor, international finance and development consultant – oral evidence

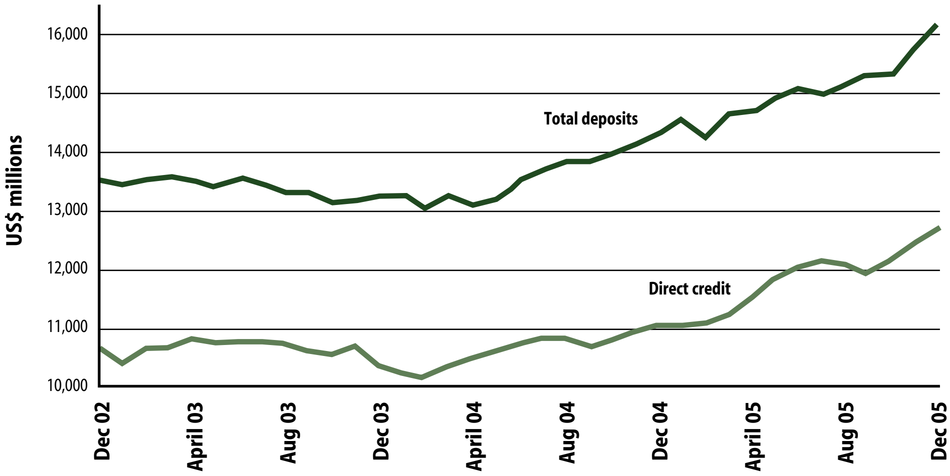
In 2003 the Peruvian Government introduced a 0.1% general financial transaction tax, with the aim of raising finance for the education sector. At this time, the national and international financial press, concerned private investors and international financial institutions such as the IMF predicted severe negative consequences to the Peruvian economy. In particular, they feared that bank deposits would

44 From HM Treasury Pre-budget report 2007, anex B, table p.12 available at www.hm-treasury.gov.uk/media/F/9/pbr_csr07_annexb_305.pdf. 2006/2007 stamp duty receipt £13.4 billion for 2006/2007 includes house and stock transactions, approximating on historical evidence 30% equates to market in shares.

45 In the US, security transaction taxes apply to transactions in publicly traded shares and exchange traded futures and options and the revenue raised is used to cover the cost of the operations of financial regulators such as the Securities and Exchange Commission (SEC). Other inormation on FTTs extracted from Stamp Out Poverty – *Taking the Next Steps,* 2007.

be withdrawn, adversely affecting the availability of credit in the economy, and thereby restraining growth rates. Graph 5 illustrates what actually happened.

Graph 5 Peru bank deposits following introduction of a financial transaction tax in 2003[46]



As can be seen, far from reducing bank deposits and therefore credit, the period following the introduction of the financial transaction tax saw both bank deposits and access to credit increase steadily.

The case for FTTs is usually based on the following arguments:

- It is not unusual for financial transactions to be taxed in some form or other;
- Where FTTs have been levied, financial markets have generally adopted them with no major repercussions;
- FTTs raise substantial amounts of revenue;
- In most cases, this income is collected electronically at the point of settlement with minimum cost to the governments;
- Neither avoidance nor evasion has proved to be a serious problem.

One of the key points that emerge from this discussion is that the foreign exchange market is unusual for not yet being taxed. Given that it is the largest financial market in the world, a levy on foreign exchange trading would be expected to raise substantial amounts of revenue provided a suitable collection mechanism could be designed at the point of trade settlement.

46 Superintendencia de Banca y Seguros, Lima – December, 2005. Also in Stamp Out Poverty – *A Sterling Solution: Implementing a Stamp Duty on Sterling to Finance International Development*, Second Edition, September 2006, p15. Available at www.stampoutpoverty.org/?lid=9889

Box 5

The Sterling Stamp Duty is not the Tobin tax

More than 30 years ago the economist, James Tobin, proposed a levy on currency transactions. His aim was to discourage speculation in foreign exchange markets by imposing a tax on all trades in all currencies across borders. Tobin's aim was to 'throw sand in the wheels of our excessively efficient international money markets'.[47] The rate he proposed was 1%, 200 times the 0.005% rate of the SSD proposal, and the income was not intended for a particular purpose, such as the alleviation of poverty.

Essentially, the two proposals are entirely different (save that they both involve a levy on currency transactions) because they are motivated by different objectives and thus differ vastly in terms of the rate at which they would be levied. Since the SSD's aim is to raise revenue the intention is for it to skim the market causing the least possible adverse impact to it. The motivation for Tobin's tax was exactly the opposite – to impede the activities of currency traders.

> *This proposal is not a proposal for a Tobin tax. It is a proposal for a levy of an entirely different magnitude, one designed for an entirely different purpose, and one proposed for a financial system, the mechanics of which have, in recent years, been entirely transformed.*
>
> People & Planet. Written submission

The SSD maybe markedly different from James Tobin's original idea but the proposal has benefited from being one of the most thoroughly researched taxation propositions in the modern cannon. Endorsed by leading academics and economists, it was reputed City think tank, Intelligence Capital, who recently wrote the blue-print[48] of how it can be implemented in such a way that would not damage the City of London, would be uneconomic to avoid but would still raise considerable revenue on an annual basis. This puts the SSD at the forefront of innovative mechanisms to finance development.

3.2 The currency market is vast and untaxed

The foreign exchange market is the world's largest and most liquid financial market. It trades globally around the clock with more than $3 trillion being traded every day, greater than the entire annual output of the UK economy.

> *There is surely something obscene about so much money being made out of something without actually producing anything, so there is a reasonable case for taxing it. This could be part of a broader attempt to equalise tax regimes around the world so that there is greater fairness and more transparency.*
>
> Andrew Lawson, Research Fellow, Overseas Development Institute – oral evidence

47 James Tobin – 'A Proposal for Monetary Reform', *Eastern Economic Journal* 4 (3–4), July 1978, based on Janeway Lectures, Princeton, 1972.

48 Stamp Out Poverty – *A Sterling Solution*

According to the latest figures from the Bank for International Settlements there were $3,210 billion worth of foreign exchange transactions a day in 2007[49] of which sterling made up 15% of global currency transactions by volume.[50] Sterling is the fourth most traded currency in the world, behind the dollar, euro and yen. London is by far the largest centre for foreign exchange trading with 34.1% of the volume – *more than the US, Eurozone and Japan combined*.[51]

The fact that these massive trades are not subject to any tax stands in stark contrast to the volume of wealth netted by market participants, such as banks, hedge funds, traders and brokers. The industry in other words, is currently benefiting from a very benign fiscal regime.

Moreover, profits in the banking sector itself continue to rise with a 21.9% increase in profits for 2006 amounting to, for the top 1,000 banks, a pre-tax total of $786.3bn.[52] UK-based companies and traders appear to benefit disproportionately from this wealth, at least according to recent work by researchers at the IMF who have classified the UK as an 'Offshore Financial Centre', or tax haven.[53]

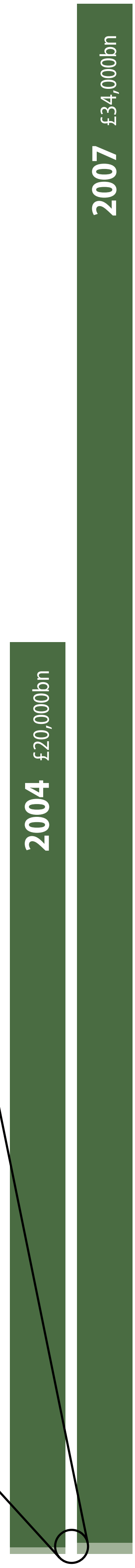
Evidence to this Inquiry suggests that the past two decades have seen significant changes in the way FX transactions are settled both nationally using Real Time Gross Settlement (RTGS) systems and internationally using the Continuous Linked Settlement (CLS) Bank. Therefore, whilst Central Banks have responsibility for ensuring the effective functioning of systemically important country-based payments systems, a country is not an island in this respect. Rather, it operates in an interconnected – and interdependent – global network of central banks and national payment systems, and cooperates in the oversight of cross-border payment systems, such as the CLS Bank.

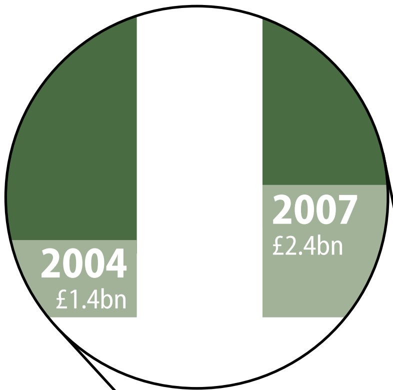
Graph 6 SSD revenue related to the size of the foreign exchange market

2004 Total sterling traded £20,000bn
SSD would have generated £1.4bn

2007 Total sterling traded £34,000bn
SSD would have generated £2.4bn

The SSD revenue generated has been calculated using the methodology employed by Professor Rodney Schmidt in *The Currency Transaction Tax: Rate and Revenue Estimates*, September 2007. Not to scale.





49 Bank for International Settlements – *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2007 – Preliminary Global Results* (Basel: Bank for International Settlements) p5. Available at www.bis.org/publ/rpfx07.pdf

50 Ibid, p7

51 Ibid, p9

52 *The Banker* Top 1,000 World Banks 2007, July 2007. Available at www.thebanker.com/news/fullstory.php/aid/5050/TOP_1OOO__World_Banks_O7.html

53 Zoromé, A – 'Concept of Offshore Financial Centers: In Search of an Operational Definition', IMF Working Paper WP/07/87, April 2007. Available at www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf

Box 6

International Payment and Settlement Systems[54]

The last two decades have seen significant changes in the practice of payments and settlement systems globally. As overseeing authorities have sought to reduce settlement risk and enhance systemic efficiency, Deferred Net Settlement (DNS) systems have given way to Real Time Gross Settlement (RTGS) systems, where – at least domestically – settlement risk is effectively eliminated due to the use of payment versus payment (PvP) and delivery versus payment (DvP). In general terms, advances in IT have led to greater uniformity, as heterodox forms have gradually been replaced by a more homogenous approach based on commonly used technical platforms, thereby greatly reducing costs through increased efficiency. Major Large Value Payment Systems (LVPS) in developed countries are increasingly interdependent. They rely on the same technological infrastructures, which ensure that this interdependence functions smoothly and effectively.

The messaging function pioneered by SWIFT (Society for Worldwide Interbank Financial Telecommunications) has become central to this process, as economies of scale considerations have made it increasingly sensible for all global players to use the same system. SWIFT, which is owned by the finance industry, now supplies messaging services to more than 8,000 financial institutions in 206 countries and territories, and thus accounts for an important part of the financial infrastructure both nationally and internationally.

For the purpose of this Report it is important to understand how currency settlement operates. In the UK, for example, the Clearing House Automated Payment System (CHAPS) is a key body in this regard. CHAPS is the organisation through which most high-value wholesale payments are processed, and it operates an RTGS system. Sterling currency transactions are settled either through CHAPS or the Continuous Linked Settlement (CLS) Bank.

These developments have today made a unilaterally implemented SSD feasible. A leading scholar in this field, Professor Rodney Schmidt, put the issue as follows: 'The infrastructure for settling foreign exchange trades is increasingly formal, centralized and regulated. This is due to new technology, subject to increasing returns to scale, and to cooperation between trading and central banks to reduce settlement risk. Settling a foreign exchange trade requires at least two payments, one of each of the currencies traded. Settlement risk is eliminated when payment obligations are matched and traced to the original trade, and then payments are made simultaneously. The technology and institutions now in place to support this make it possible to identify and tax gross foreign exchange payments, whichever financial instrument is used to define the trade, wherever the parties to the trade are located, and wherever the ensuing payments are made.'[55]

3.3 Implementation[56]

To be effective an SSD would need to have the following attributes:

- be implemented relatively easily and cheaply, using existing market infrastructure and networks;
- capture the vast majority of sterling transactions globally; and
- be set at a sufficiently modest level as to neither distort the market nor provide incentives for financial institutions to move outside current systems in order to avoid paying it.

Developments to the functioning and regulation of the foreign exchange market strongly indicate that implementing a Sterling Stamp Duty can be done in such a way as to capture the vast majority

54 This draws on evidence submitted by Dr Stephen Spratt to this Inquiry.

55 Schmidt, R – 'A Feasible Foreign Exchange Transaction Tax', North-South Institute, submitted as part of the written evidence of Rodney Schmidt.

56 Much of this section is drawn from evidence by Dr Stephen Spratt and also features in his report: *A Sterling Solution*.

of all sterling transactions. The method for 'plumbing' the duty into the system has been extensively researched by one of this Inquiry's principal contributors, Dr Stephen Spratt and an overview of this methodology is presented here.

Since the launch of the CLS Bank in 2002, a growing share of FX transactions have migrated to it. Today it is estimated that a little over 60% of all global sterling trades are conducted through the CLS system. Of the remainder, the overwhelming majority are processed through CHAPS. The majority of sterling transactions are settled in the CLS system, where it would be a straightforward task to identify them.

Having accounted for the sterling FX trades conducted through the CLS system, it is necessary to capture the remainder that are processed through CHAPS. A key feature of the various interlinked systems through which FX transactions can be settled is their use of the SWIFTNet messaging system. This global reach offers the chance to further extend the scope of the SSD, and ensure that all FX related sterling trades in CHAPS are identified.

Within each of the systems in which it operates, SWIFTNet provides secure payment messaging between members through its FIN system and, crucially, has a dedicated message form – the MT300 – which is used to confirm individual FX trades. That is, whether in the CLS system, CHAPS or a multilateral netting system, an FX trade is confirmed between the counterparties by means of a SWIFTNet FIN MT300 message, or one of its variants.

The MT300 message is initially exchanged by or on behalf of the parties that have agreed to a foreign exchange contract. The fact that MT300 messages also provide notification of amendments to contracts and cancellations of previously held confirmation is important for the purposes of this proposal, as it ensures that the SSD is only levied on sterling FX transactions in the form in which they are ultimately transacted. Also, because MT300 messages confirm individual FX trades, they precede any subsequent bilateral netting process that may occur, after which identifying the individual trades concerned may not be possible.

The MT300 messaging system can therefore capture the lion's share of sterling transactions in the 'traditional' FX market. However, this still leaves the area of the OTC derivatives market. In one important respect, this market is also covered by the MT300 messaging series, which is used to confirm that FX options have been executed. In this case, MT305 and MT306 are used as messaging formats. All other FX OTC derivative contracts are contained within the third category of SWIFTStandard messaging formats, which range from MT300 to MT341 and from MT350 to MT399. As with the traditional market, messages require the currency, amount and counter parties to be identified within the message, as well as the facility to amend or cancel contracts.

The next stage of implementation is to gather relevant messages of this form in a central location, to enable the SSD to be levied. Again, it is possible to 'piggy-back' upon existing networks by using the SWIFTNet FIN Copy messaging function. The majority of recipients of SWIFT FIN Copy messages are central banks, as the messages facilitate settlement in the centralised RTGS systems. The ideal template is FINInform, where copied messages are triggered to the central bank depending on either the identity of the parties or the type of message sent.

A key aspect of the proposal is therefore to establish a SWIFTInform messaging service, which is triggered by the sending of an MT300–MT399 FX message, in either the traditional or the OTC derivatives market. In this instance, a copy of parts of the message – currency, volume and counterparties – is automatically sent to the Bank of England for every FX transaction involving sterling. As with all aspects of the proposal, this process would be automated and would require no dedicated infrastructure.

The following figures illustrate how the Sterling Stamp Duty could be collected in practice based on existing settlement systems.

Figure 1 The Global Sterling Payment and Settlement System[57]

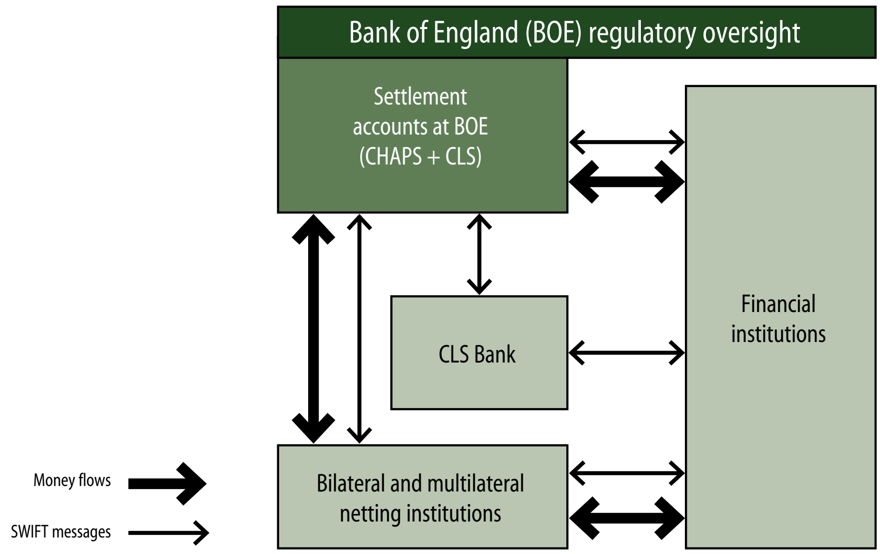
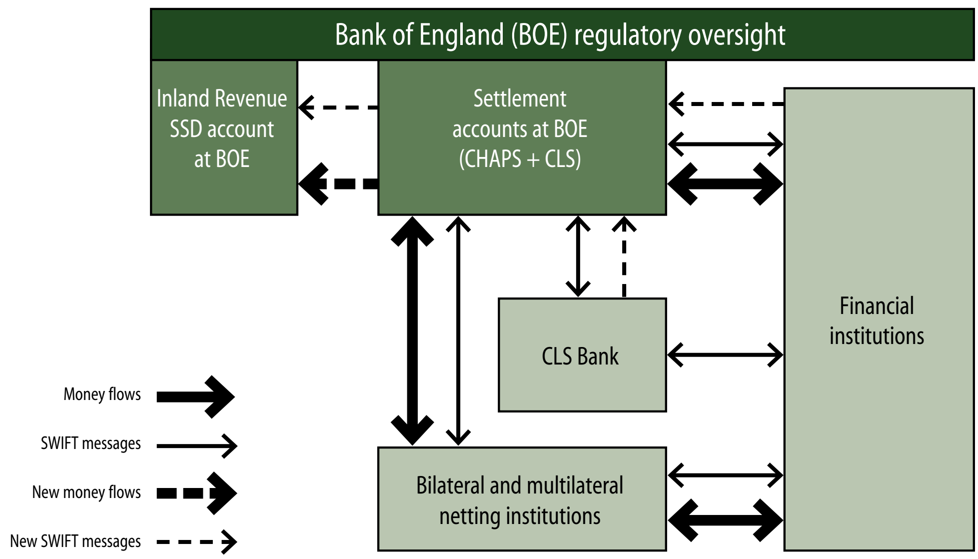


Figure 2 The Global Sterling Payment and Settlement System with the Sterling Stamp Duty[58]



3.4 Collecting the SSD and preventing avoidance

Once identified in the manner described above, collecting the SSD would be a relatively straightforward process. To be able to participate in the CLS system, financial institutions must hold an account with the CLS Bank. However, in practice, UK-based CLS Bank members actually hold their accounts within the Bank of England. These accounts can then be credited and debited by the institution in accordance with their liquidity requirements for CLS Bank. To collect the SSD from the CLS system, therefore, the levy could be directly taken from the relevant accounts.

57 Adapted from Stamp Out Poverty – *A Sterling Solution*, p34

58 Adapted from Ibid, p35

Similarly, in order to be a member of CHAPS, a financial institution must hold a settlement account at the respective central bank. Therefore, once the tax to be paid is identified, it can be transferred from the relevant settlement account held at the central bank to the account of the finance ministry also held at the central bank.

The SWIFT messaging system in general, and the FINInform Copying function in particular, is completely automated on a day-to-day basis. Consequently, though the relevant systems would have to be slightly modified to facilitate tax identification and tax-take from the appropriate centrally held accounts, the changes would be relatively minor. Furthermore, it seems that once the fixed start-up costs were met, the marginal cost of operating the system would be very low.

Direct members of both the CLS System and country-level Large Value Payment Systems (LVPS) are relatively few in number, with a significant proportion of all trades being undertaken by members on behalf of their third-party customers. Whilst these market participants would not be directly taxed, they would be affected by the SSD, which would be directly reflected in the spread charged them by the CLS Bank/CHAPS in exchange for executing their FX business.

The remaining sterling trades undertaken would still be identified by use of the SWIFTNet messaging service described. Furthermore, these trades would be settled by correspondent banks on behalf of the underlying corporate. These banks would hold accounts with the respective central banks, the CLS Bank, or both. Consequently, such FX trades would ultimately also incur the SSD.

Even the London Investment Banking Association (LIBA), which opposes the stamp duty, acknowledges 'that the development of the RTGS system and the CLS bank make it easier to do this [implement the duty] than would have been the case in the absence of these systems.'[59] Amicus, the trade union, many of whose members work in banking, agreed that implementing a tax on sterling transactions was feasible and could be done with minimal expense and planning.[60]

The economic incidence would, in the first instance, fall upon the large financial institutions that are members of the CLS Bank and CHAPS. While there is little doubt that major banks could comfortably afford this, (see Table 1) it is likely that they will endeavour to pass these costs on.

Table 1 Profits of major global FX trading banks[61]

Bank	Annual Profit 2005	Annual Profit 2006
HSBC	$20.97bn	$22.09bn
Citigroup	$24.59bn	$21.54bn
JP Morgan Chase	$8.48bn	$14.44bn
Barclays	$10.51bn	$14.19bn
UBS	$11.62bn	$10.14bn
Goldman Sachs	$5.63bn	$9.54bn
ABN Amro	$8.12bn	$9.30bn
Deutsche Bank	$8.31bn	$8.07bn
Merrill Lynch	$5.12bn	$7.50bn
Morgan Stanley	$4.94bn	$7.47bn

59 Oral evidence of Ian Harrison and Jonathan Taylor (LIBA) to this Inquiry.

60 Written evidence of Amicus to this Inquiry.

61 Adapted from Ibid, p38 with updated data from CNN US Bank Data. Available at http://money.cnn.com/magazines/fortune/fortune500/2006/index.html – and each institution's financial statements for 2006 for non-US Banks. US dollar figures have been converted at exchange rate of 1 October 2007.

3.5 The SSD in practice

In May 2007, INTL Global Currencies, a City of London firm specialising in foreign exchange with developing countries, ran a week-long trial of a currency transaction charge to raise money for charity. It implemented the 0.005% rate being examined in this Report but applied it to all currencies it traded, as its sterling business was not large enough to support the trial alone. Philip Smith, its Director, said that the five-day trial raised £4,000. This revenue was donated to the charity Widows and Orphans International, for a project in Kenya working with relatives of people who have died of AIDS.[62]

In his evidence to this Inquiry Philip Smith explained: 'It's not a huge amount but we felt it was illustrative of a week's turnover for us across all our countries. And we're not an enormous entity which would have raised a lot more.' He said it took a 'press of a button' to add the levy into its system. 'Once the amount was set in stone that was it. It was then just left alone and the report came out of the end of the week, thank you very much – very straightforward.' He said INTL had informed his clients about what was happening and said the feedback was very positive. Nobody had commented on any problems and he added that rolling the levy out on a larger basis would be very simple: 'It's just an extra feature in our dealing system and I would imagine every financial institution would have a similar set-up and therefore it was as easy as pressing a button.'[63]

3.6 Ring-fencing revenue for development

> *Overall I do think that in the current political context, the development of some targeted taxes linked to some targeted spending are a way of addressing the large gap between the 0.7% commitment and what a number of countries have been able to deliver.*
>
> Nobel Laureate, Professor Joseph Stiglitz

Governments have traditionally resisted efforts to link a particular revenue raising method to a particular target. The orthodox approach is to raise revenue through a variety of means and then allocate money according to the political priorities of the day. In this theory, ring-fencing taxes simply distorts these priorities and risks cutting spending allocations to other equally important areas that are not protected by ring-fencing.

However, increasing the stability of overseas aid revenue is important simply because development is traditionally one of the areas particularly vulnerable to spending cuts during times when general government revenues fall: 'Since it is so important to have stability of these revenues for development purposes, it is natural to try to find sources of revenue that have more stability [and] are more protected.'[64]

Hypothecation of specific funds to an aid-related purpose is seemingly not something which the Government has an objection to in principle. A letter from No.10, HMT and DfID on 9 March 2006,

62 Oral evidence of Philip Smith to this Inquiry.

63 Ibid.

64 Oral evidence of Professor Joseph Stiglitz to this Inquiry.

stated that 'the UK will set aside part of the revenue from its existing Air Passenger Duty to provide a long-term stream of finance for the IFFIm and IFF.'[65]

Several contributors cited the need for public accountability and validity as a justification for ring-fencing the revenues from the proposed Sterling Stamp Duty. Amicus said that hypothecating would provide a predictable, additional income stream. 'It would avoid being seen as a stealth tax since the revenue would directly fund international development and contribute to our MDG commitments.'[66] Others said that if the income generated was earmarked for a specific purpose such as UNITAID or the Global Fund, the risk of the Government being accused of introducing another stealth tax could be avoided.[67]

Ring-fenced revenue streams also have the advantage of being seen by recipient countries as a predictable source of finance around which they can set long-term budgets. The failure of rich countries to provide funding guarantees for more than five years was seen as a major failing of the current ODA system. 'The huge advantage of dedicated levies is that the agency funded by it can make long-term funding commitments to developing countries and thus engage in partnerships that target meaningful goals,' said Khalil Elouardighi. He continued: 'If the 10% of the adult population of Africa that is infected with HIV were given access to treatment and then the flow of drugs stopped abruptly due to a priority change in the West, the consequences of them all falling back into AIDS and dying at the same time would be catastrophic.'[68]

The ODI stated that any new source of revenue should be protected from being absorbed into general ODA budgets, where it risked disappearing from view. Because aid budgets are 'fungible' – meaning that new revenues can be offset by cuts in existing budget allocations – there was a danger the net amount of money given in aid would remain the same. UKAN stressed that 'innovative financing must not be seen as a means of relieving rich countries of their obligations.'[69] In other words a failure to ring-fence the revenues could allow governments to use the revenues to offset cuts in their budgets with the long-term consequence that total funding would not increase.

It was a clear message of the accumulated evidence of development experts to this Inquiry that any innovative financing inititiatives implemented by the UK Government, including a Sterling Stamp Duty, should not be used as a justification for reducing general aid budgets. Innovative finance must be not only predictable and practical, but also *additional*.

RECOMMENDATION

That the UK Government undertake rigorous research in an open and transparent manner into the implementation of a 0.005% stamp duty on all sterling foreign exchange transactions, to provide additional revenue to help bridge the significant financing gap required to meet the Millennium Development Goals.

65 Letter to parliamentary colleagues signed by the Prime Minister, the Chancellor of the Exchequer and the Secretary of State for International Development, March 2006.

66 Written evidence of Amicus to this Inquiry.

67 Oral evidence of Andrew Lawson to this Inquiry.

68 Written evidence of Khalil Elouardighi to this Inquiry.

69 Written evidence of UKAN to this Inquiry.

4 Answering objections

> *It is highly implausible that a very small tax of 0.005% will make a dent in London's status as the world's financial centre.*
>
> Dr Ha-Joon Chang, Cambridge University[70]

In Section 1 we set out the considerable funding gap required to meet the Millennium Development Goals (MDGs). In Section 2 we reviewed existing innovative financing mechanisms and suggestions for possible new instruments concluding that urgency dictated focusing on a well-researched proposal that could be implemented without delay. In Section 3 we examined the Sterling Stamp Duty (SSD) proposal in some depth. In Section 4 we review the evidence put to this Inquiry to satisfy ourselves as to whether the SSD is a genuinely feasible and desirable vehicle for the generation of new development revenue.

It is perhaps helpful to reiterate the central reason why the SSD proposal is so markedly different from the Tobin tax (other than the dramatic difference in its rate) since it addresses the principal argument concerning whether it would work in practice; namely whether financial actors in a globalised system would avoid payment. The following explanation draws on a number of submissions, notably from Professors Rodney Schmidt and Stephen Spratt, answering critics who have historically argued that unless every country were to implement a currency transaction tax at the same time, currency trades would relocate to another sovereign territory to avoid paying the transaction charge.

It was argued that the SSD overcomes this criticism because it is a duty implemented by a country on its own currency (in this instance, sterling) wherever it is traded in the world, as opposed to on all currencies traded in the country (i.e. including all dollar, euro, yen and other currency trades conducted within the borders of the UK).[71] This is a critical distinction. It is the key to feasibility, not least because it allows unilateral progress by one country or a group of like-minded countries. It works because the Bank of England features at the heart of large value trades of sterling, wherever they are transacted in the world, including tax havens. The duty can therefore be applied and collected regardless of the geography of the trade. The payment of an SSD, like the Stamp Duty Reserve Tax on shares, would be a legal obligation. To avoid paying it would be a risk to an institution's reputation not warranted for the sake of paying a duty as small as a half of one hundredth of 1%.

It is also necessary to detail the different motivations between the SSD and the Tobin tax – a measure with which it is sometimes confused. The purpose of the 1% tax James Tobin proposed in the 1970s was essentially to drive out virtually all currency business that did not have a basis in the trade of

70 Oral evidence of Dr Ha-Joon Chang to this Inquiry.

71 Oral evidence of Sony Kapoor; written evidence of Dr Stephen Spratt and Dr Rodney Schmidt to this Inquiry.

goods and services. This would, as he put it, 'throw sand in the wheels'[72] of the financial system and deter vast movements of capital profiting from tiny differences in currency values, with their potential for destabilising economic consequences.[73] In Tobin's model, financing development was not a component. The motivation for his tax was specifically to restructure the workings of the foreign exchange market. To realise it would have required global agreement and a multilateral simultaneous implementation almost certainly beyond the bounds of political possibility.

The SSD is an entirely different proposition. Its raison d'être is as a financing instrument for development. Its rate of 0.005% (200 times smaller than the Tobin tax) is designed specifically not to hamper normal market operations but instead to skim a tiny fraction of the volume traded. Any country that chooses to implement such a measure on its own currency can do so unilaterally. The two proposals share an association with currency, but there the similarity ends.

4.1 The view of HM Treasury

HM Treasury said in its submission that it had concluded that there were 'several obstacles' surrounding the effectiveness and implementation of a Sterling Stamp Duty. 'After consideration of the proposal, the Government has reached the view that such a tax could not be practically enforceable given the multiple avenues for avoidance, and the consequently heavy regulatory and implementation costs such a tax would require.'

However, the Treasury stated in August 2005, in a written response to points raised by Stamp Out Poverty, that: 'Technically, it is possible to apply a unilateral sterling CTT via CLS… CLS Bank settle in fifteen currencies, and in doing so must apply the relevant laws in each jurisdiction – including, for example, a unilateral sterling currency transaction tax.' It also appears that HMT is basing its response to the SSD proposal on analysis that pre-dates Stamp Out Poverty's *Sterling Solution* Report (September 2006). A Freedom of Information request aimed at shedding light on Treasury analysis into the SSD proposal did not return any detailed consideration or reports. Due to lack of information as to what 'the multiple avenues for avoidance' which Treasury officials identified actually are, it is not clear why such a tax 'could not be practically enforceable'.

The *avoidance* issue has become all the more pertinent since 11 September 2001 after which there was a considerable tightening of financial control to combat money laundering and the financing of terrorism. Avoidance in this climate is very difficult, especially as all electronic transactions leave an e-trail.

Moreover, this Inquiry also took evidence drawn from the most up-to-date report on currency transaction taxation conducted for the UN University by Professor Rodney Schmidt of the North-South Institute whose findings have kindly been made available to this Inquiry prior to their publication. In his paper Professor Schmidt was tasked with using the most modern econometric modelling techniques to assess the effect on the market of the implementation of a 0.005% currency transaction tax (CTT) in terms of the relationship between the spread and transaction volume. We shall draw upon his findings below but in the section on 'Tax evasion' Schmidt delivers a robust counter to HMT's initial assertion about 'multiple avenues for avoidance' upon which their secondary assertion about 'heavy regulatory and implementation costs' are built.

'Some people worry that many foreign exchange transactions are netted away before being settled and would not be taxed…All financial and foreign exchange settlement systems, whether gross or netting, formal or informal, multilateral or bilateral, track and match individual ('gross') transactions through their operations. All of them, whether on- or off-shore, require an account with the central bank that issues the currency in which the gross transaction is denominated. Finally, all use the same messaging

72 His intention was to 'throw sand in the wheels of our excessively efficient international money markets'. Tobin (1978) 'A Proposal for Monetary Reform', *Eastern Economic Journal* 4 (3–4) July

73 At the time of the South-East Asian crisis (1997/1998) Tobin's idea was plucked from relative academic obscurity as a conceivable tool to counter aggressive speculative activity.

cum netting system created and operated centrally by SWIFT. Ultimately, all these settlement systems are overseen and regulated by the central banks. To set up alternative settlement operations would be to go back to the informal proprietary systems and technologies of thirty years ago, something much more costly in money and risk than the CTT.'[74]

Professor Schmidt's findings also show the potential of this revenue stream if it were to be levied on the world's four most traded currencies (dollar, pound, euro and yen), 'A 0.5-basis-point CTT would raise at least US$33 billion every year, probably more.'[75]

4.2 Objections from the finance sector

It is certainly indicative of the approach of parts of the banking sector in the evidence they presented that they were determined to link the SSD proposal to the Tobin tax, even though specifically asked not to do so (a criterion respected by all other witnesses including the Treasury). Goldman Sachs's evidence consisted of a PowerPoint presentation entitled: 'Tobin Taxes – Good intentions, Bad Consequences'.

However, aside from this, the British Banking Association (BBA) and the London Investment Banking Association (LIBA) produced a series of important criticisms of the proposition that are necessary to address in order to have confidence in the efficacy of the proposal. These objections have been grouped into four distinct categories, under which some of the specific points have been quoted.[76]

4.2.1 AVOIDANCE

- ***An SSD '[would] drive foreign exchange business off shore and out of London' – BBA***
- ***'There would be a risk of losing transactions and activities, and hence employment, to the financial centres which do not apply the tax' – BBA***
- ***It is unclear 'how [the SSD] applies to…legal entities not registered or domiciled in the UK [such as the CLS Bank]' – LIBA***

In regard to *avoidance* issues, raised by both the BBA and LIBA, the central point is that the SSD targets sterling transactions wherever they take place in the world, as opposed to applying to all currency transactions (dollar, euro, yen) that take place in the UK. This is a crucial distinction. It works because the Bank of England features at the heart of large value trades of sterling, wherever they are transacted globally, including tax havens. The duty can therefore be applied and collected regardless of the geography of the trade. Since the geography of the transaction is immaterial to capture of the tax, there is no incentive to avoid the duty through relocation of the currency trade.

Professor Schmidt's work on this issue[77] strongly suggests that the potential to evade a currency transaction tax, whether by netting foreign exchange transactions before final settlement, using offshore or informal settlement systems, or using derivatives to mediate foreign exchange transactions is negligible.

The point about wholesale payment systems is that they must maintain close links with central banks and regulators because of their size. Communications technology between participants and systems, whether onshore or offshore, is sophisticated, standardised and almost always provided by SWIFT, an industry-owned co-operative. It would therefore be difficult or costly to disguise or hide foreign exchange payments on a large scale. Foreign exchange derivatives require payment just as ordinary transactions do.

74 Schmidt, R – *The Currency Transaction Tax: Rate and Revenue Estimates*, The North-South Institute, October 2007, p3

75 Ibid, abstract

76 All of the quoted objections are taken from the oral evidence of Ian Harrison and Jonathan Taylor (LIBA) and the written evidence of LIBA and the BBA to this Inquiry.

77 See Schmidt, R – 'Efficient Capital Controls', *Journal of Economic Studies*, 28 (3) 2001 p199–212.

Between them the CLS Bank and RTGS together capture all the transactions. It is hard to imagine that the CLS, which depends in part on a credit line from the Bank of England, would say no to a UK law that said that at the point of settlement there would be a collection of a 0.005% duty on the gross amount.

> *'If a Cayman Island Bank, in a tax haven, sells pounds sterling for dollars with another bank that is in Bermuda, the tax liability will still arise because this transaction still has to settle either in the CLS or under the aegis of the Bank of England.'*
>
> Sony Kapoor, international finance and development consultant – oral evidence

Evidence from the Treasury that 'CLS Bank settle in fifteen currencies, and in doing so must apply the relevant laws in each jurisdiction – including, for example, a unilateral sterling currency transaction tax' suggests that officials are clear that if the UK Government wanted to apply such a duty the CLS would comply.

Another alternative would be to set up a rival system to CLS in order to circumvent the will of the UK Government. However, it does not seem that there is a rational incentive for banks to move outside the existing frameworks to avoid the tax. That would involve heavy investment in a new system and writing off capital expenditure already spent on ensuring compatibility with CLS. In any event it is highly unlikely that regulators, who devoted vast resources to setting up CLS and RTGS to avoid systemic risk, would sanction the creation of a parallel system.

4.2.2 THE RATE VERSUS SPREAD AND LIQUIDITY

- ***The SSD 'would distort the market and perhaps lead to less hedging of exposures…reduced liquidity would make stabilizing long-term arbitrage more risky, thereby increasing transaction costs more than the tax levied' – BBA***
- ***'Narrowing spreads will mean [that the SSD] will affect profits substantially' – LIBA***

The rate at which the SSD is levied is critical and fundamental to its successful implementation. Most financial experts giving evidence to this Inquiry asserted that the 0.005% proposed rate of the SSD was too low to cause market distortions.

Critics claimed that the SSD would lower liquidity by encouraging traders to achieve wider spreads to compensate for the duty while shunning deals with narrower spreads. They further said that higher transaction costs would in turn lead to more volatile movements in prices. Critics also said that even at 0.005%, foreign exchange (forex) traders would be encouraged to find ways to avoid payment. One submission stated the volume of trading in sterling combined with computerisation and competition had driven the spreads to '0.1 or 0.2 in the fourth decimal place'. This would be equivalent to 0.0001%. LIBA stated the average spread – the difference between the bid price and the ask price – on currency transactions was 0.003%.[78] This meant that a proposed 0.005% tax would be equivalent to a 167% VAT rate on each transaction.

However, figures from the International Monetary Fund show that spreads in inter-bank wholesale markets were 0.023% for US dollar/yen transactions and 0.021% for US dollar/UK pound. In *A Sterling Solution*, Stephen Spratt states that the average spread on a foreign exchange transaction was 0.015% (1.5 basis points).[79] In the absence of verifiable evidence to the contrary, it appears clear that a 0.005% tax is, at worst, one third of the average spread.

78 Oral evidence of Ian Harrison and Jonathan Taylor (LIBA) to this Inquiry.

79 Stamp Out Poverty – *A Sterling Solution*, p44

Several witnesses argued that the stamp duty would be treated as a transaction cost just like the processing fees that are routinely collected in Large Value Payment Systems. The extra cost of the duty would simply be absorbed into the overall transaction costs borne by the market participants. The profits made on foreign exchange transactions are also affected by the volatility of the exchange rates involved and the duty would not become a factor that drove financial institutions to change the way they did business.

It was argued that it was important to understand all the elements of cost in a foreign exchange transaction. The first is the impact that making a major transaction or series of transactions has on the market. Buying £100bn in dollars will push the price of dollars up, eroding some of the sought-after gain from the deal. The second cost is the risk that prices will change due to market volatility. The third element is the spread, widely accepted to be the smallest part of the transaction cost.[85]

> *Very little profit is made on the spread. Profit is made on dealing with clients to whom a higher margin is quoted.*
>
> Sony Kapoor, international finance and development consultant – oral evidence

Traders hope to make profits by speculating on currency movements far in excess of six basis points. Assuming that brokers would simply pass on the stamp duty to these traders, the average spread they would pay across the four major sterling currency pairs would therefore increase from 0.06175% to 0.06675%. As Stephen Spratt put it: 'Given the profits made in the FX market it is inconceivable that this would have any material impact on decisions to initiate a trade or not.'[81]

Experience suggests that financial markets will always resist the imposition of charges, but once imposed the markets will work round them. The 0.5% Stamp Duty on share transactions is an obvious example. As discussed above, there is no sign that investors are moving to Tokyo or New York to avoid this duty. In fact London has continued to be successful in attracting overseas companies to float in the City. Financial markets have a very efficient means of pricing risk and policy changes into the prices they charge and the investment decisions they make.

> *Throughout history proposals to introduce such levies have been met with dire predictions of the collapse of the financial system. However it is also the case that such claims have proven to be without foundation.*
>
> Stephen Spratt, a director at the New Economics Foundation

It was noted that on the London Stock Exchange trading in shares in a major company such as Vodafone carried a spread of between five and 10 basis points (0.05% and 0.1%), a rate five or 10 times the amount of the proposed Sterling Stamp Duty. 'Yet people don't sit outside the London Stock Exchange and complain '…[that] the liquidity has been hurt or share volatility is higher,' he said, adding there was no evidence volatility was higher at the London Stock Exchange than in Tokyo or other exchanges.[82]

80 Oral evidence of Sony Kapoor to this Inquiry.

81 Written evidence of Dr Stephen Spratt to this Inquiry.

82 Oral evidence of Sony Kapoor to this Inquiry.

4.2.3 THE MARKET WILL INNOVATE

- ***'Financial institutions would create new instruments, perhaps using derivatives or non-deliverable forwards, which give investors the same economic exposure to exchange rate movements without actually doing a short term FX transaction' – BBA***
- ***'Banks would move to contracts for difference (CFDs) to get around the tax' – LIBA***
- ***'[Banks are] likely to move to netting and other solutions very quickly' – LIBA***

Being one of the most dynamic markets in the world, any judgement on the feasibility of a currency transaction tax must take into account not only how the SSD would change the market, but how the market may change around the SSD. LIBA said that the market would be 'strongly motivated' to find ways around the duty. This could include wholly offshore trading in non-UK resident sterling, use of derivatives and synthetic products and much increased use of bilateral netting arrangements. 'They could lead to the large volume sterling exchange market moving wholly offshore and in the longer term to large banks moving their European forex operations away from London,' LIBA submitted.[83] It later submitted that it had been 'advised' that CLS would swiftly lose business if the tax were imposed. It said that even now CLS's customers were looking at establishing netting solutions – a less formal system that incorporates a delay in settlement – to lower the current charge of £1 per transaction. It said while netting transactions would go through RTGS, they would not necessarily appear as forex transactions and that the reporting requirements needed would resemble 'the capital controls of financially unstable countries'.

It was countered that these claims were misleading. The central point of the SSD proposition is that the tax is payable on all sterling transactions, regardless of where in the world the trade takes place. The tax liability occurs at the point that a transaction is agreed. The duty will ultimately be paid at the point of settlement. Netting solutions, it was argued, cannot be seen as an alternative to the CLS or to the RTGS – they are a complement. Although a proportion of transactions (for example between customers with accounts at the same bank) can still be netted, this would not affect the central principles of the SSD proposal, namely that an informational e-trail would still be generated and there would be a legal requirement to pay the tax. It was also claimed that netting is more risky than gross real time settlement and that it was highly unlikely that banks would be willing to take such risks, nor pay the 'operational risk' charge imposed upon them in the form of higher capital adequacy requirements, under the new Basel accord.

A further reply to the argument that the market may innovate was that the Contract For Difference (CFD) market does not provide a viable alternative to normal FX markets partly due to the extra risks involved and partly due to the fact that spreads are typically 2–3 basis points higher here than in spot markets and not worth using in order to avoid a 0.5 basis point duty.[84]

4.2.4 UK COMPETITIVENESS IN INTERNATIONAL FINANCIAL MARKETS

- ***An SSD 'would heavily restrict access to the foreign exchange market for sterling participants; and the resulting loss of UK foreign exchange business to international competitors' – BBA***

A key point critics raised was that the imposition of a levy will have negative implications for the competitiveness of the UK's financial services sector. Unless all other major financial centres join in, this duty would serve to drive foreign exchange business out of London, it was claimed. This would clearly amount to a substantial loss for the UK economy.

Sterling is certainly a very important member of the top four currencies. London is currently the pre-eminent financial centre in the world, larger than New York, Frankfurt or Tokyo. As we have seen, the

83 Evidence of LIBA to this Inquiry.

84 Written evidence of Sony Kapoor to this Inquiry.

latest figures from the Bank for International Settlements show that more than a third of all foreign exchange transactions now take place in the UK.[85] But witnesses argued that this status is not based on it being the lowest priced market. If that were the case, it is certain that emerging financial centres would already have taken a chunk out of London's market share. London's strength instead derives from the highly developed institutions, high-quality human resources and most importantly, the invisible networks between the firms and individuals that have been built up over the past three centuries. It does not appear plausible that a very small tax of 0.005% – equivalent to a £500 charge for a £10m transaction – would make a major dent in London's status as the world's financial centre. Andrew Lawson of the ODI said, 'It seems unlikely that a 0.005% Sterling Stamp Duty would have a significant effect on the London financial market.'[86]

It seems instead that the financial sector's opposition may be heavily based on the reluctance of the industry and its clients to give up part of their wealth. In the current climate of vast and growing disparity between rich and poor in the UK, a government that introduced this measure is likely to find significant public support for such a move.

> *'In the end the market will bear whatever it has to bear. When in this country they first tried to introduce regulation of child labour, people were up in arms saying it was infringing their freedom of contract. Whenever you try to introduce regulation and taxation, those who have to bear the cost will always scream.'*
>
> Dr Ha-Joon Chang, University of Cambridge

4.3 A moral argument

Several contributors said there was a strong moral issue to the SSD proposal. Philip Smith of INTL asked rhetorically: 'Would banks actually want to be seen to be bypassing, not tax avoidance but aid avoidance?'[87] People & Planet said the proposal would allow those who had benefited most from globalisation to be clearly seen to be giving something back to 'those who have, so far, lost out'.[88] Amicus, described it as the 'winners of globalisation providing for the losers' adding that, 'linking this industry with poverty alleviation would also be beneficial for the City' in the wake of a run of record profits in the banking sector, huge bonuses for individual traders and criticism of some banks for using tax avoidance strategies to effectively take money out of the reach of governments of poor countries.[89]

85 See Section 3.2, Footnote 51, above.

86 Oral evidence of Andrew Lawson to this Inquiry.

87 Oral evidence of Philip Smith to this Inquiry.

88 Written evidence of People & Planet to this Inquiry.

89 Written evidence of Amicus to this Inquiry.

Conclusion

> *What are the principle obstacles to the implementation of a Sterling Stamp Duty? Simply political will and the power of the City of London in influencing this will.*
>
> Stephen Spratt, a director at the New Economics Foundation

Commentators now summarise remaining opposition to the SSD proposal as coming from three groups:

1. Those who have not followed the latest work on the subject and are therefore stuck in the past – for example those who still think the proposal is the Tobin tax;
2. Current market participants, who for self-interested but wholly understandable reasons may oppose the duty – bankers, fund managers and lobbyists for the financial services industry among them. It is to be expected that the financial sector will argue vociferously against a new tax laid at its door;
3. Academics and officials who, though they work on financial market issues, have not worked in the market themselves and are influenced by the current market participants.

Taking into account the views of the Treasury, and the understandable opposition from the BBA and LIBA, on the one hand, and submissions from the likes of leading academics and finance experts such as Professors Stiglitz, Schmidt, Persaud[90] on the other, we conclude that on the balance of the evidence provided to this Inquiry, it seems very likely that a Sterling Stamp Duty set at 0.005% can be inexpensively implemented, would capture the vast majority of sterling transactions around the world and, if set at this low level, would not lead to avoidance or cause adverse effects to UK trade or the City of London. It would, however, raise in the region of £2.44 billion per annum in additional finance for international development.

RECOMMENDATION

That the UK Government undertake rigorous research in an open and transparent manner into the implementation of a 0.005% stamp duty on all sterling foreign exchange transactions, to provide additional revenue to help bridge the significant financing gap required to meet the Millennium Development Goals.

90 See preface to Stamp Out Poverty – *A Sterling Solution*.

5 The UK fulfilling a global leadership role

> *'The UK is without doubt a substantial leader on development policy, not only in the EU but worldwide, so the implementation of such a tax by the UK would be very closely observed.'*
>
> Susan McAdams, Multilateral and Innovative Financing Director, World Bank[91]

One of Mr Brown's first actions as Prime Minister was to ask Ministers for International Development, Foreign Affairs, Business and Trade, Treasury and the Environment to report on what must be done to meet the world's Millennium Development Goals and to eradicate what he called 'the great evils of our time' – illiteracy, disease, poverty, environmental degradation and under-development. He praised IFFIm, an innovative financial mechanism and said that the 'greatest of challenges now demands the boldest of initiatives'. In this context, the UK Government's official opposition to a Sterling Stamp Duty that would generate substantial additional development finance on an annual basis looks increasingly untenable.

It was the Treasury who pointed to the Government's proactive role in development finance. In its joint submission with DfID it highlighted the role played by the British presidency of the G8 Gleneagles Summit in July 2005 in cementing a deal to double aid to Africa and give an extra $50bn a year globally by 2010. It said the UK had played an important role in shaping the international development debate in recent years. These included helping to put the MDGs and poverty reduction at the centre of policymaking, and in reforming the global development architecture. 'The UK has been more effective influencing others when adopting ambitious goals itself,' they said referring to the commitment to pay 0.7% of GNI in aid.[92]

The World Bank and the Norwegian Government both highlighted the role the UK would play as a pioneer of currency tax as an innovative method of financing development. In her written submission Susan McAdams, Director, Multilateral and Innovative Financing at the World Bank, said: 'The UK is without doubt a substantial leader on development policy, not only in the EU but worldwide, so the implementation of such a tax by the UK would be very closely observed.'[93]

91 Written evidence of Susan McAdams to this Inquiry.

92 Written evidence from Treasury/DfID to this Inquiry.

93 Written evidence of Susan McAdams to this Inquiry.

Erik Solheim, Norway's Minister of International Development, went further saying: 'Were the UK to implement a currency transaction development levy in the form of the 0.005% levy proposed, this could…pave the way for support and follow-up from other countries.' Others commented that UK backing for a duty might well 'embolden' French politicians to follow suit.[94]

> *The London City perception is shared across the euro zone and the inspiring effect of a British sterling transaction tax would extend to member states of the euro zone.*
>
> Simon Dubbins, Director of International, Amicus – written submission

In its submission, the Japanese Government hinted that it could follow a lead from the UK, which is a fellow member of the G8. Although it said that its fiscal position meant it was reluctant to commit to the air ticket solidarity levy, IFFIm or UNITAID, it said: 'Japan carefully observes and collects information of developments in innovative financial mechanisms, by interested states and organisations.'[95]

The State of Kenya, on behalf of 46 African countries, in their submission represented a growing voice from Southern countries favouring the introduction of this measure. 'The Currency Transaction Levy aims to redistribute wealth from the most prominent beneficiaries of globalisation, to those who have been left behind by the same globalisation. The benefits to health are immense.'[96]

If other major currencies followed sterling and adopted a currency transaction development levy, the potential revenues would be considerable. Rodney Schmidt of the North-South Institute estimated that a co-ordinated transaction tax levied on the four major world currencies – dollar, euro, yen and sterling – would yield annual revenue of $33.41 billion (£16.36 billion).[97]

Next year presents a perfect opportunity for the UK Government to exert a leadership role at two conferences on development finance, being held in the second half of 2008 – the Accra High Level Conference on Aid Effectiveness and the UN Financing for Development Conference in Doha. Taking a more proactive role in the Leading Group on Innovative Finance would also be appropriate for a UK Government committed to eliminating global poverty and it should be encouraged to host a forthcoming Leading Group conference.

The Prime Minister, Gordon Brown, in his speech to the United Nations in July 2007 spoke passionately of the emergency of global poverty and the need for bold initiatives to tackle it. The UK Government must ensure that his words are matched with actions. The dire situation in much of the developing world, particularly sub-Saharan Africa, demands strength and determination from world leaders. Skimming a tiny proportion of the wealth created by the global financial industry to help to bridge the massive development funding gap by implementing a small Sterling Stamp Duty is a measured, considered and appropriate response. In so doing, the UK can enhance its role on the world stage and recognise its huge potential to influence other countries to follow suit.

94 Written evidence of the Norwegian Government to this Inquiry.

95 Written evidence of the Japanese Government to this Inquiry.

96 Written evidence of H.E. Dr Tom Mboya Okeyo, Permanent Mission of Kenya to the United Nations Office, Geneva.

97 See Section 4.1, Footnote 75, above.

6 Conclusion

The evidence collected by this Inquiry suggests that a Sterling Stamp Duty, set at the appropriate level, could provide considerable sums, at little cost, towards meeting the Millennium Development Goals. Since the proposed levy depends on currency trading for revenues, it also provides an opportunity for the City of London to show that in the wake of record profits, huge bonuses and concerns over the negative impacts of globalisation, it is making a direct quantifiable contribution to international aid and poverty relief.

The Government should undertake open and careful research into the Sterling Stamp Duty as an innovative means of meeting its MDG commitments. It should carefully avoid ‘in principle’ objections to new taxation instruments to increase development revenue and give particular attention to the experiences of other countries that have implemented similar levies. The potential for leadership by the UK in this area is considerable. But imagination and strength of purpose will be essential if we are to make the most of our privilege and fulfil our promises to the poorest inhabitants of our shared planet.

7 Recommendations

In light of the conclusions reached by this Inquiry and presented in this Report, the All Party Parliamentary Group on Debt, Aid and Trade recommend that the UK Government:

1 Undertake rigorous research in an open and transparent manner into the implementation of a 0.005% stamp duty on all sterling foreign exchange transactions, to provide additional revenue to help bridge the significant funding gap required to meet the Millennium Development Goals.

2 Encourage other OECD nations, particularly European countries, to strongly consider implementing a similar levy on their own currencies with the aim of multiplying and internationalising the effort to create a new, predictable, long-term stream of finance to help meet the Millennium Development Goals.

3 Work with other like-minded countries to research, develop and urgently implement other new sources of development finance.

4 Ensure that the UK and any other countries that implement currency transaction development levies adhere to the principle that this finance is *additional* to aid already committed to reach the 0.7 per cent target of GNI for ODA.

5 Participate in the International Taskforce for the investigation of a Currency Transaction Development Levy agreed at the Leading Group Conferences in Oslo and Seoul.

6 Play a more active role within the Leading Group on Solidarity Levies to Fund Development and seriously consider hosting a forthcoming conference of the Leading Group.

Finally, we urge Ministers to encourage HMT to give serious consideration to the Sterling Stamp Duty proposal, especially since it is now so widely accepted by finance experts as entirely feasible.

> *‘I cannot believe that a Sterling Stamp Duty at the rate of 0.005% would result in the diversion of financial transactions from the UK to other countries… At this low rate, the Sterling Stamp Duty is an entirely feasible proposal.’*
>
> Nobel Laureate, Professor Joseph Stiglitz

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Appendices

A1 Organisations and individuals who submitted evidence

NAME	ORGANISATION	EVIDENCE TYPE
The Rt Hon Ed Balls MP	Her Majesty's Treasury (HMT)	Written (joint with DfID)
Jenny Bryer	National Board of Catholic Women	Written
Simon Burall	Overseas Development Institute (ODI)	Written
Oliver Buston	Debt, Aid, Trade, Africa	Written
Ha-Joon Chang	Cambridge University	Oral
Kevin Daly	Goldman Sachs	Written
Lieven Denys	Legal Expert on Currency Taxation	Written
Simon Dubbins	Amicus International	Written
Khalil Elouardighi	ACT UP Paris/UNITAID	Written
Government of Brazil	Government of Brazil	Written
Government of Japan	Government of Japan	Written
Government of Norway	Government of Norway	Written
Sarah Hague	Save The Children	Written
Michael Hammer	One World Trust	Written
Ian Harrison	London Investment Banking Association	Oral and Written
Sony Kapoor	International finance and development consultant	Oral and Written
Angela Knight	British Bankers' Association (BBA)	Written
Bandula Kothalawala	Trade Unions' Congress (TUC)	Written
Andrew Lawson	Overseas Development Institute (ODI)	Oral and Written
Ian Leggett	People & Planet	Written
Thomas Mboya	The Africa Group	Written
Susan McAdams	The World Bank	Written
Sarah Mulley	The UK Aid Network (UKAN)	Written
Jon Pender	GlaxoSmithKline	Oral
Avinash Persaud	Intelligence Capital	Written
Rodney Schmidt	The North-South Institute	Written
Philip Smith	INTL Global Currencies	Oral
Stephen Spratt	New Economics Foundation	Written
Joseph Stiglitz	Columbia University	Oral
Jonathan Taylor	London Investment Banking Association	Oral and Written
The Rt Hon Gareth Thomas MP	Department for International Development (DfID)	Written (joint with HMT)
Simon Williams	The Cooperative Bank	Written

A2 Questions asked by the Group

The following questionnaire was sent to all those who submitted written evidence:

1 As we approach the half-way point for the MDGs and there is now a greater focus on how the Goals can be paid for, to what extent is it necessary to generate additional sources of finance over and above traditional ODA?

2 To what extent does current disbursement of development assistance meet requirements of predictable, sustainable and long-term aid?

3 What in your view are important recent successes in Official Development Assistance?

4 What is the case for additional sources of development finance being generated through 'nationally collected, internationally disbursed' duties or levies?

5 What precedents are there for financial transaction levies and how effective are they in generating income? These range from the UK stamp duty on shares to more general financial levies across much of South America.

6 Does the UK have significant influence on the international development policies of other EU countries? In particular, if the UK were to pioneer a Sterling Stamp Duty to bolster its development spending, to what extent could this encourage the introduction of a development levy on Euro currency transactions?

7 Would you consider a Sterling Stamp Duty a desirable way to generate finance for development? This concentrates on an appraisal of the modern proposition of a very small levy on sterling currency transactions (at 0.005%), a rate low enough not to disrupt market activity yet high enough to produce substantial revenue. This proposal is not the Tobin tax, which at a rate 200 times higher than the current proposal, was designed to alter market structure and discourage speculation, and not to generate finance for development. The Tobin tax is therefore not the subject of this Inquiry.

8 What are the principle obstacles to the implementation of a Sterling Stamp Duty?

9 How important are new complementary financing mechanisms such as the UK-led International Finance Facility for Immunisation (IFFIm) and the French-led UNITAID, to bridge the funding gap for the achievement of the MDGs? This would consider not only the variety of potential revenue streams but also the speed and ease with which they can be implemented.

10 What are the advantages and disadvantages of funding international development goals from a specific hypothecated duty? For example, the French air passenger levy is the principal source of finance for UNITAID.

A3 Abbreviations

AMC	Advance Market Commitments
APPG	All Party Parliamentary Group
BBA	British Bankers' Association
BIS	Bank for International Settlements
CHAPS	Clearing House Automated Payment System
CLS	Continuous Linked Settlement
CTDL	Currency Transaction Development Levy
CTT	Currency Transaction Tax
DAC	Development Assistance Committee
DfID	Department for International Development
DNS	Deferred Net Settlement
EC	European Commission
ECA	Export Credit Agency
EU	European Union
FTT	Financial Transaction Tax
Forex/FX	Foreign Exchange
G8	Group of 8 (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States)
G10	Group of 10 (actually 11: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States)
GAVI	(formerly known as) The Global Alliance for Vaccines and Immunisation
GNI	Gross National Income
HMT	Her Majesty's Treasury
IFFIm	International Finance Facility for Immunisation
IMF	International Monetary Fund
LDC	Less-Developed Country
LIBA	London Investment Banking Association
LVPS	Large Value Payment System
MDG	Millennium Development Goal
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-Operation and Development
RTGS	Real Time Gross Settlement
SSD	Sterling Stamp Duty
SWIFT	Society for Worldwide Interbank Financial Telecommunications
UKAN	UK Aid Network
UNMP	United Nations Millennium Project
USAID	United States Agency for International Development