



The Tobin Tax

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The American economist James Tobin first made the suggestion for a tax on currency transactions to dissuade short term currency speculation in the 1970s. The idea has been discussed on by politicians, economists and bankers at various times over the last thirty years, often in the wake of major economic crises, where governments have found themselves powerless to prevent the value of their currency from plummeting, despite costly intervention by their central banks. Many of those advocating the use of such a tax have seen it as a way to fund international initiatives, particularly those against global poverty. It is clear that to be effective, a Tobin tax would have to secure a substantial degree of international co-operation, and in the absence of this kind of consensus developing, critics have argued that, for all its attractions, a Tobin tax is wholly impractical.

However, the prospects for reform have changed substantially in the last couple of years. The crisis in the international banking system and its impact on the world economy have illustrated the risks inherent in other financial markets – not just the market for foreign exchange. In addition taxpayers in many countries have provided considerable sums to bail out individual companies, and to restore stability to the global system. The ability of the largest banks to return to robust financial health, and to reward their top personnel handsomely, has increased the political pressure for a change in the industry's culture, in particular, its attitude to risk, and for credible methods to recover these costs.

In a speech to G20 Finance Ministers in November 2009, the then Labour Prime Minister, Gordon Brown, suggested four possible reforms to provide “a better economic and social contract between financial institutions and the public”: namely, “an insurance fee to reflect systemic risk or a resolution fund or contingent capital arrangements or a global financial transactions levy.”¹ Since then, there has been a public campaign for a Tobin-like ‘Robin Hood Tax’, the possibility of an international levy on the banking system has been discussed at the G20, and in September 2011 the European Commission published proposals for an EU-wide tax on financial transactions. For its part the Coalition Government has taken the position that such a tax would only be viable in implemented on a global scale, and there remain many questions over its design and operation, casting doubt on whether it might ever be introduced. This note provides a short introduction to this issue.

¹ 10 Downing Street press notice, *Prime Minister's speech to G20 Finance Ministers*, 7 November 2009

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1 The origins of the Tobin tax

The 1970s saw the gradual breakdown of a series of controls on exchange rates and capital flows constructed in the immediate post war period, and with this, the development of the world market in currency transactions. While the growth of this market was impressive, some commentators feared that it posed serious risks: in particular, that domestic economies could suffer lasting damage from the consequences of massive currency fluctuations, driven by the short-term interests of speculators. Governments would be powerless to counteract the effects of rumour and panic in trading, as even investors who saw no reason to bet against a particular currency, would have no choice but to follow the market.

During this period the distinguished American economist, the late James Tobin, developed the idea for a tax on exchange transactions. In a paper he wrote in 1978, he argued that this risk was inherent in the fact that goods and labour, and the prices at which they were sold, could not move or change with anything like the speed of capital. Wholesale economic integration between countries was a solution to the problem, but infeasible. As a consequence, he was forced to “regretfully recommend” the alternative: “to throw some sand in the wheels of our excessively efficient international money markets” by means of “an internationally uniform tax on all spot conversions of one currency into another, proportional to the size of the transaction.”

Tobin anticipated that this type of tax would particularly deter “short-term financial round-trip excursions into another currency”, flattening out the extreme movements seen in currency prices, and so restoring the influence of fiscal and monetary authorities to shape exchange rate policy.² As Tobin argued in a collection of essays on the tax, published in 1996, “my main objectives for the tax are two ... to make exchange rates reflect to a larger degree long-run fundamentals relative to short-run expectations and risks ... [and] to preserve and promote autonomy of national macroeconomic and monetary policies.”³ In his 1978 paper, he acknowledged the problems in administering the tax, but suggested this was not, in itself, sufficient reason to reject it: “Doubtless there would be difficulties of administration and enforcement. Doubtless there would be ingenious patterns of evasion. But since these will

² Tobin raised the issue first in a series of lectures at Princeton in 1972, before summarising his ideas in, “A proposal for international monetary reform”, *Eastern Economic Journal*, 4 (July-October) 1978 pp 153-159. This paper is available online at: <http://www.globalpolicy.org/component/content/article/216/45989.html>

³ Mahbub ul Haq et al ed., *The Tobin Tax: coping with financial volatility*, 1996 pp xii-xiii

not be costless either, the main purpose of the plan will not be lost. At least the bank facilities which are so responsible for the current troublesome perfection of these markets would be taxed, as would the multinational corporations.”

For some critics, the need to obtain international consensus, particularly on the distribution of any proceeds from the tax, made it a non-starter. As one commentator noted, “individual countries may have an incentive to resist imposing the tax in order to capture the bulk of the world’s foreign exchange business, and there is no obvious enforcement mechanism by which governments tempted to free ride can be compelled to co-operate.”⁴ In an interview in 2001 Tobin himself noted, “having a tax of this kind adopted depends on international agreement ... and since the US is dead against it, it is not going to happen.”⁵

Others have argued that there is no reason to believe that cutting the number of transactions would reduce their speculative nature. More fundamentally, it is suggested that it is far too simplistic to see a basic division between the “real” variables driving exchange rates - GDP, growth, unemployment, etc – and certain “unreal” ones that help create speculative bubbles and crashes. Writing in the *Independent* in the wake of the Asian economic crisis in 1997, which saw the collapse in currencies, stock prices and asset values across the region, the economist Diane Coyle made this point, arguing that, “the evidence is that financial markets, and not just their bubbles, can be inherently self-fulfilling”:

There is no true valuation corresponding to an objective set of economic fundamentals. To see this, just think about the importance of technology stocks in Wall Street’s long bull run. None of the investors in these software and biotech companies has the remotest idea how valuable they ought to be, and the stocks trade at awe-inspiring prices while the companies’ earnings remain low or even negative. There is simply too much uncertainty about future demand for different types of high-tech products, not to mention the underlying science ... In today’s high-speed markets, a change in expectations can rapidly create a new future. As soon as the general optimism about the Tiger economies foundered, for whatever reason, their currency and stock markets crashed and, lo, their economic future no longer looks rosy. This is not to say that fundamentals do not matter at all, for it is also true that the Asian economies were labouring under weak banking systems, corrupt loans and bad government. If this were not the case, they could probably have sailed quite swiftly out of the crash, as the western economies did after the stock market crash of 1987. As it is, recovery is going to take a long haul of political and institutional reform as well as the IMF’s economic medicine. In the real economy, the fundamentals do still matter. But not in the markets, and this gets back to why the Tobin tax is misguided.

As Paul Davidson, an economics professor at the University of Tennessee, pointed out in a presentation to the annual conference of the Royal Economic Society last month, the available empirical evidence suggests that a reduction in transactions costs on 1 May 1975, making the US stock market more liquid and bringing in more investors, reduced the volatility of share prices. This is consistent with the view that the market is entirely self-fulfilling, because in that case the more investors there are, the more likely there are to be different views about where the market is heading. Bubbles still emerge - they do so whenever a critical mass of investors adopts the view that it is heading up

⁴ Barry Eichengreen, “Conclusion: the Tobin Tax: what have we learned?”, from Mahbub ul Haq et al ed., *The Tobin Tax: coping with financial volatility*, 1996 p 276

⁵ “US opposed to tax aimed at curbing speculators”, *Financial Times*, 30 August 2001

and up. Increasing transaction costs via a tax would not only not prevent bubbles but would also increase day-to-day volatility.⁶

2 Debates in the late 1990s

Tobin's focus when he first suggested a tax on currency exchange was very much on the wider economic damage caused by currency speculation. However, in the late 1990s when proposals for a Tobin tax were reinvigorated, the debate focused as much on the benefits to be realised from the distribution of the tax's proceeds: in particular, supporters argued that the profits from what were purely paper transactions should go towards an internationally beneficial end, such as relieving Third World debt. As Tobin himself commented, "in recent years, the burdens on the United Nations and other international organisations have multiplied, while fiscal and political circumstances have caused national governments to curtail their financial support. As a result, the Tobin tax has been seen as a possible source of funds for international purposes. For some advocates of the tax, this is the principal motivation."⁷

In 1999 the charity War on Want launched a campaign for a Tobin tax, as an "efficient method of public financing world development": an extract from the organisation's briefing pack is reproduced below:

Q. Why now?

A. The Tobin Tax has steadily gained support for three main reasons. All three are of increasing relevance.

1. The volume of foreign exchange trading has steadily grown, in fact it has far outstripped the amount necessary to carry out trade. Up to \$2 trillion a day is traded, and only 5% of this is necessary for financing trade in goods and services. All the rest is speculative activity (in 1975 80% of these transactions were trade-related).

2. The progressive advance of globalisation and the trend towards the deregulation of financial and foreign exchange markets, has exacerbated the inherent volatility of these markets. Traders go through bouts of pessimism and optimism, not necessarily related to economic realities, causing financial markets to swing violently. This constant yo-yoing can have dramatic adverse effects on an economy, particularly on the poor. The result is often unemployment and increases in interest rates, forging the conditions for recession.

3. The Tobin Tax has gained credibility as an efficient method of public financing of world development, especially when most developed countries are unable or unwilling to meet their aid promises. According to the OECD, total global aid to developing countries has fallen by about 15% in the last 2 years alone.

Q. What would be the effect of a Tobin tax?

A. A small universal tax on foreign exchange transactions will deter speculation, thus reducing the volatility of global financial markets and providing a measure of stability. It will give countries a "breathing space", creating more scope for the use of fiscal and monetary policy within nation states. Secondly, it would provide a new, independent source of global revenue. Even after the calming effect is estimated that a 0.25% tax could raise up to \$250 billion per annum, which can be used for social development and poverty reduction all around the world ...

⁶ "This is not the way to stop markets blowing speculative bubbles", *Independent*, 28 May 1998

⁷ Mahbub ul Haq et al ed., *op. cit.* p xvi

Q. How will the tax be collected?

A. At present, 84% of all foreign exchange transactions occur in just nine countries. Introduction of the Tobin Tax in these and a few other countries may initially provide a workable tax regime. We recommend that the tax be instated through an international agreement, backed by national legislation. It should be applied where the transactions occur or where the deal is made, making collection of the tax the responsibility of the national central bank. The setting up of a global settlement bank, the Continuous Linking Settlement (CLS) Bank, in mid-2000, will make identification and taxing of currency transactions much simpler. The CLS Bank will track settlements of all deals-around the clock and thus facilitate the tax.

Q. Who will administer the tax revenue and how should it be distributed?

A. Given the social nature of the proposed use of the revenue, it would be appropriate if the UN body of organisations administered it. It is the only existing institution with the reputation and mandate to decide how the money should be distributed. Revenue collected by central banks should be deposited with an appropriate UN body. The collected funds can then be used by the various arms of the UN (UNDP, UNESCO, UNCTAD and UNICEF) to eradicate poverty and pave the way for long term sustainable development. According to a UNDP estimate, the cost of eliminating the worst forms of worldwide poverty would be about \$80 billion per annum. Similarly, Jubilee 2000 estimate that \$160 billion is the approximate cost of wiping out the South's unpayable debt. A 0.25% Tobin Tax, raising \$250 billion a year, would provide substantial independent financing of global aid provision. This is especially relevant in light of the last decade's drastic reduction in global aid disbursements.⁸

Following the launch of the War on Want campaign, Melanie Johnson, then Economic Secretary to the Treasury, said, in answer to a PQ, that "the Government believe the idea of a tax on currency speculation is, in principle, interesting, but has a number of practical drawbacks. It would be almost impossible to achieve global coverage, and there would be huge scope for avoidance."⁹ Nevertheless a considerable number of Members supported the campaign, with 114 Members signing an EDM in favour of a Tobin tax, which Harry Barnes MP put down in January 2000.¹⁰ Over the following months the issue was debated at some length both in the Lords¹¹ and the Commons – in the latter case, in an adjournment debate in Westminster Hall.¹² On this occasion Stephen Timms, then Financial Secretary, gave a more detailed list of objections, suggesting that the tax would be "practically impossible to implement effectively"; an extract from his speech is reproduced below:

The Tobin tax ... is an interesting idea, but it has a number of serious likely or possible drawbacks. First, it could introduce serious economic distortions to the international financial system. International currency transactions bring huge economic benefits by facilitating trade and investment flows. Restricting currency exchanges through taxation could have quite serious economic side effects. It might endanger economic growth in some of the least well-off countries. Some currency transactions undoubtedly reflect pure speculation and contribute to financial crises, but others help economic adjustment and market stability. Currency transactions ... are not all sinful. They are not all speculative. A Tobin tax would not distinguish between the two. By slowing the adjustment of financial markets, the tax would slow recovery from a crisis.

⁸ War on Want, *It's time for Tobin: Q&A*, April 1999

⁹ HC Deb 16 December 1999 c 297W

¹⁰ EDM 312 1999/2000, 24 January 2000. 114 Members signed a second EDM Mr Barnes put down in the next Session (EDM 595 2000/2001, 23 April 2001).

¹¹ HL Deb 8 June 2000 cc 1307-1323

¹² HC Deb 18 April 2000 cc 143-162WH

Artificially slowing market adjustments to genuine price shocks would have a higher economic cost than rapid adjustment.

Secondly, and perhaps more tellingly, it is not certain that a modest tax would have much effect in a crisis. It might hit routine, day-to-day transactions, but it is unlikely to prevent the high volume flows seen at times of crisis ... There is a good argument, which has been advanced in this debate, that a Tobin tax might increase volatility by reducing liquidity. Liquid markets are more efficient and price transparent. That argument is borne out by what has happened in some emerging markets. Their transaction costs are already high compared with those in the City of London. It could be said that that amounts to a tax on capital flows, yet those are precisely the markets that have suffered from serious currency instability and capital flight ...

Thirdly, a Tobin tax would be practically impossible to implement effectively ... The UK has been leading the fight against international tax evasion and avoidance. We have taken a number of important steps in that regard, but we simply do not live in a world where taxes can be set and enforced at an international level. Every country jealously guards economic sovereignty on tax. Are we ready to cede our authority over tax matters to an international body? I do not believe that we are. Whatever we think about financial secrecy havens and offshore centres, we must acknowledge their existence. Most of them are sovereign nations exercising exactly the influence over their tax affairs that the House and the UK Government exercise over tax matters in the UK. No international mechanism--not the G7, the IMF or the UN--is in a position to secure the agreement of all the countries in the world, or even those with a significant financial centre, to impose a Tobin tax, but that would be required to make the tax workable.

Currencies can be traded anywhere. We know how quickly capital markets can move. Traders would simply move their activities to regimes without the tax, with the likely result that the market would become less well regulated. We currently host about a third of the world's currency transactions--worth \$637 billion a day. If a tax were imposed on foreign currency traders, they would move their activities to somewhere with less regulation. Driving the markets offshore to poorly regulated centres would add to the instability of the financial system at the cost of substantial job losses in the UK. Even it were possible to achieve the universal agreement that would be needed, there would still be huge scope for avoidance.

A large body of academic study is available on the Tobin tax; some support the idea and others oppose it. No one has successfully answered the concerns that I have set out. We must draw policy conclusions in the context of the practical realities of our wider international financial responsibilities. There is no multilateral mechanism for establishing a tax, and little international appetite for it. We are pleased that organisations such as War on Want and Oxfam are engaged in the international debate about how we can ensure the stability of the international financial system and how we channel resources to the poorest countries. As Oxfam has said, the more visionary the proposals for spending tax revenue, the harder it may be to gain political acceptance for the tax. The best strategy seems to be to promote the less controversial suggestions regarding use of revenue and try to increase the allocation to development over the longer term.¹³

Although proponents of a Tobin tax continued to make their case, the Labour Government showed little inclination in pursuing it. In November 2002 the Lords Economic Affairs Committee published a report on globalisation, which touched on the idea: in evidence to the

¹³ HC Deb 18 April 2000 cc 161-162WH. Martin Wolf set out a similar list of objections in the *Financial Times* at this time: "Misplaced hopes in Tobin's tax", 20 March 2002.

Committee, the then Chancellor, Gordon Brown, argued that Tobin himself, prior to his death earlier that year, had suggested it would be much harder to implement, given the degree of deregulation seen in capital markets since the 1970s:

It is significant that Professor James Tobin, who originally proposed the tax, withdrew his support for the idea. The Chancellor put it this way: "Before he died Professor Tobin distanced himself from the apostles of the Tobin tax. The reason was that the Tobin tax was conceived in a different world of capital markets that were basically national and regulated. He thought, at the time, it was quite easy to impose a transactions tax. In actual fact, in a highly liberalised market, that is not regulated in the same way as it was by national governments in 1970s and 1980s, it is far more difficult to impose this anyway." ...

Sir Edward George, Governor of the Bank of England, said that he was not an enthusiast of a Tobin tax in general. He said he thought some capital flows are good and some are bad and a Tobin tax could not distinguish between the two. He thought "the killer ... on the Tobin tax is practicality, because foreign exchange markets can go anywhere in the world ... [so] you would divert a lot of foreign exchange market activity to places that did not apply the tax. I think that is not a productive thing to do"¹⁴

Similarly, in a written answer in March 2006, the then Economic Secretary, Ivan Lewis said, "the Government have studied the technical implications of this proposal carefully, and after serious consideration of the proposal it 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."¹⁵

3 Debate on Tobin taxes following the financial crisis

In August 2009 the chairman of the Financial Services Authority, Adair Turner, argued that the financial crisis had shown that parts of the sector had grown "beyond a socially reasonable size." He noted that as governments were faced with the gigantic costs of restoring stability to global markets, and the successful survivors returned to profitability, "if you want to stop excessive pay in a swollen financial sector you have to reduce the size of that sector or apply special taxes to its pre-remuneration profit."¹⁶ (Lord Turner recast his argument in a lecture on financial reform in early 2011, suggesting that most innovation in the banking sector in recent years had added little to economic growth, and tackling the banks' ability to extract 'rent' or income could involve state intervention in the market and/or taxes on financial activities.¹⁷)

The strength of the reaction from bankers in London, New York and elsewhere suggested that the crisis had, in fact, made the Tobin tax, a viable proposition.¹⁸ As a correspondent to the *Financial Times* noted, "the ire Adair Turner has drawn from the financial industry suggests he is on the right track. Whether the Tobin tax itself is a good idea matters little.

¹⁴ Select Committee on Economic Affairs, *Globalisation*, 18 November 2002 HL Paper 5 2002-03 para 298

¹⁵ HC Deb 21 March 2006 cc353-4W

¹⁶ "FSA chief backs City curbs with global tax", *Financial Times*, 27 August 2009

¹⁷ FSA press notices, [Speech by FSA Chairman: Reforming finance: are we being radical enough?](#), 18 February 2011 – see also, "Turner's 'radical' changes at the banks", [Peston's Picks: blog by BBC business editor Robert Peston](#), 1 March 2011

¹⁸ For example, "Bankers' anger at FSA chief's tax proposal", *Guardian*, 28 August 2009

But he recalibrates the debate by asking: what kind of financial sector is most useful to society as a whole? Which parts actually add something to the economy and which only skim off value created elsewhere? No surprise that most bankers loathe such questions.”¹⁹

In a critical editorial the *Financial Times* acknowledged that “Lord Turner’s stating premise is important. The financial sector is bloated and the taxpayer is backing its risks because some financial institutions are now too large to fail ... During the bubble, financial institutions reaped extraordinary profits. During the panic, governments saved the core banks, thinning out competition. Now the survivors, notably the investment banks are reaping huge profits.”²⁰ The paper went on to suggest that it would be “foolish in the extreme unilaterally to erode [Britain’s] advantage” in financial services with a UK Tobin tax, although, as Lord Turner observed a couple of days later, he had not actually suggested this.²¹ Some days later the German finance minister, Peer Steinbrück, made a different case for a Tobin tax: that “a global financial-transaction tax, applied uniformly across the G20 countries, is the obvious instrument to ensure that all financial-market participants contribute equally ... to finance the costs of the crisis.”²²

In a surprising speech to a meeting of the G20 Finance Ministers on 7 November 2009, the then Prime Minister, Gordon Brown, suggested that a Tobin tax might be feasible, as one method to improve the regulation of international financial markets. In his speech, Mr Brown set out a number of measures that had resulted in “a profound transformation in the way financial markets are regulated”, but went on to argue that the G20 should “discuss whether we need a better economic and social contract to reflect the global responsibilities of financial institutions to society.” Mr Brown mentioned four possible reforms: “an insurance fee to reflect systemic risk or a resolution fund or contingent capital arrangements or a global financial transactions levy”; an assessment of which of these might be appropriate would have “to be set against four core principles”:

First, they would have to be global: to reflect the existence of the world’s first truly global sector and thereby create a level playing field for its operation. They would need to be implemented by all responsible financial centres in the world - the US, Europe, Asia, the Middle East and Switzerland. Let me be clear: Britain will not move unless others move with us together. Second, they would have to be non-distortionary to avoid damaging reductions in liquidity, inefficient allocation of capital and the temptation of avoidance. Third, any measures should complement - and reinforce - the action we are already taking to enhance the stability of the international financial system and the global economy. Fourth the contribution we ask the global financial services sector to make must be fair, measured and enable financial services to make their necessary contribution to future economic growth.

He went on to explain that the IMF would produce a report on this issue by April 2010.²³

Most comment on Mr Brown’s speech focused on the proposal for a financial transactions tax, with many finance ministers and central bankers dismissing the idea. The US Treasury Secretary, Tim Geithner, was quoted as saying, “a day-by-day financial transactions tax is not something we are prepared to support”, while the then head of the IMF, Dominique

¹⁹ “Letter: So much anger – Turner must be on the right track”, *Financial Times*, 31 August 2009

²⁰ “Editorial: Cutting finance back down to size”, *Financial Times*, 28 August 2009

²¹ “Turner stands fast against ‘ridiculous’ backlash on Tobin tax”, *Financial Times*, 31 August 2009

²² “A tax on trading to share the costs of the crisis”, *Financial Times*, 25 September 2009

²³ 10 Downing Street press notice, *Speech by the Prime Minister to G20 Finance Ministers*, 7 November 2009

Strauss-Kahn, reportedly said that the Tobin tax was “a very old idea that is not really possible today.”²⁴ Other critics reiterated this concern: an editorial in the *Times* argued more recently “[even if] all the main financial centres signed up for a tax ... that still leaves the offshore financial centres. It is difficult to see what possible incentive they would have to implement a tax when it would plainly be in their financial interest to attract business from international banks.”²⁵ For his part, Lord Turner told the *Financial Times* he welcomed the idea being raised: “I don’t know and I don’t think anybody knows whether on further analysis any of these ideas can really be implemented but after a crisis this big ... it’s appropriate to ask the appropriate bodies to look in detail at all the issues.”²⁶

Over the next few weeks some commentators argued that a tax on financial transactions *could*, in fact, be implemented. Writing in the *New York Times*, Paul Krugman, the Nobel-prize winning economist, suggested it was an idea “whose time has come”:

The main argument made by opponents of a financial transactions tax is that it would be unworkable, because traders would find ways to avoid it. Some also argue that it wouldn’t do anything to deter the socially damaging behavior that caused our current crisis. But neither claim stands up to scrutiny. On the claim that financial transactions can’t be taxed: modern trading is a highly centralized affair. Take, for example, Tobin’s original proposal to tax foreign exchange trades. How can you do this, when currency traders are located all over the world? The answer is, while traders are all over the place, a majority of their transactions are settled — i.e., payment is made — at a single London-based institution. This centralization keeps the cost of transactions low, which is what makes the huge volume of wheeling and dealing possible. It also, however, makes these transactions relatively easy to identify and tax.

What about the claim that a financial transactions tax doesn’t address the real problem? It’s true that a transactions tax wouldn’t have stopped lenders from making bad loans, or gullible investors from buying toxic waste backed by those loans. But bad investments aren’t the whole story of the crisis. What turned those bad investments into catastrophe was the financial system’s excessive reliance on short-term money. As Gary Gorton and Andrew Metrick of Yale have shown, by 2007 the United States banking system had become crucially dependent on “repo” transactions, in which financial institutions sell assets to investors while promising to buy them back after a short period — often a single day. Losses in subprime and other assets triggered a banking crisis because they undermined this system — there was a “run on repo.” And a financial transactions tax, by discouraging reliance on ultra-short-run financing, would have made such a run much less likely. So contrary to what the skeptics say, such a tax would have helped prevent the current crisis — and could help us avoid a future replay. Would a Tobin tax solve all our problems? Of course not. But it could be part of the process of shrinking our bloated financial sector. On this, as on other issues, the Obama administration needs to free its mind from Wall Street’s thrall.²⁷

In December 2009 the Treasury published a discussion paper on options to ensure the financial sector “might contribute to the potential costs of any residual risks it poses to taxpayers and to broader social objectives.”²⁸ The paper rehearsed the pros and cons of

²⁴ “Brown retreats on tax plan”, *Financial Times*, 9 November 2009

²⁵ “Editorial : No time for Tobin”, *Times*, 11 December 2009

²⁶ “Turner welcomes focus on levy”, *Financial Times*, 9 November 2009

²⁷ “Taxing the speculators”, *New York Times*, 27 November 2009

²⁸ HC Deb 10 December 2009 c25WS

some form of international tax on the financial sector, without coming to any firm conclusions, though it was relatively optimistic as to the prospects of co-ordinated action:

Proposals for a financial transaction tax must have the commitment of all the major international financial centres in order to work. ... Such coordination may now be more likely. It has been argued that taxable activities would relocate offshore from major centres. In the past, weak international coordination and the existence of non-compliant jurisdictions would have made this a significant risk. However the G20's concerted action over the last year on tax havens and non-complaint jurisdictions demonstrates that such international coordination is both feasible and enforceable.²⁹

However, the paper noted that there were considerable difficulties in designing a tax, if its purpose was to fall only on that category of transactions that posed the greater risk, not only to the banks concerned, but society as a whole:

If influencing market behaviour is the objective of the tax, a vital first step would be to assess the economic and therefore social value of the type of activity affected. If a financial transaction tax is to be aimed at reducing activity that is economically undesirable, perhaps because it contributes to financial instability, it would make sense for it to be aimed at those transactions that create the greatest distortions, such as off balance sheet transactions. These transactions have been cited by some commentators as having played a contributory role in the recent crisis. However, they may also be the most difficult items to tax.

Any new taxes could through adjustments to relative prices introduce further distortions elsewhere. This second distortion may turn out to be more detrimental than the original externality the tax had been designed to fix. Therefore any design proposal would need to be subject to a rigorous analysis of costs and benefits, carefully balancing public and market interests. The incidence of a financial transaction tax must also be considered. Generally speaking, increasing the tax burden on the financial sector must either impact on its shareholders, its employees or its customers. If a transaction tax is to be targeted at the financial sector because of specific characteristics of that sector, then it needs to be clearly ascertained that the incidence of the tax will not in practice fall on end users of financial services within the economy at large.³⁰

At this time the BBC's business editor, Robert Peston, suggested that the difficulties in distinguishing between good and bad trades were an insurmountable obstacle:

The gaping hole in the Treasury's paper is any analysis of which financial transactions may be gratuitous - or "socially useless" to use Adair Turner's resonant phrase - or even potentially destabilising for the economy. If such transactions could be identified with confidence, then taxing them might be harmless to the prospects for sustainable economic growth or even a good thing.

All that the Treasury trots out are the same old stats showing the exponential growth of financial transactions in recent years. For example, it mentions that the outstanding gross value of over-the-counter derivatives rose from less than \$100 trillion dollars in 1998 to almost \$700 trillion in 2008 (or more than 10 times the value of everything the world produces per annum). Now it's not ludicrous to conclude that a big chunk of those transactions were either designed to transfer wealth in a sophisticated gull from naïve investors to clever bankers, or to avoid tax, or to manufacture fees out of

²⁹ HM Treasury, *Risk, reward and responsibility: the financial sector and society*, December 2009 paras 4.17-9
³⁰ *op.cit.* paras 4.22-4

products with no serious underlying purpose. It is also arguable that a proportion of those deals have not had a net smoothing effect on markets as a whole but have increased the volatility of share prices, and commodity prices and debt prices - in a way that may actually have damaged the interests of genuine wealth creating companies in the real economy, by making it harder for them to plan.

But although such intuitions may be reasonable, intuitions are no basis for levying a new tax. What would be required is solid data ...Unless and until such data can be collected, the debate on whether a transaction tax could or should be implemented is probably going nowhere.³¹

In early January 2010 President Obama proposed a levy to be imposed on the largest financial institutions in the States, to recuperate the costs of the Federal Government's 'TARP' program for recapitalising the banks.³² An editorial in the *Financial Times* suggested that "while a Tobin tax-like transaction levy is a non-starter, insurance has something going for it:"

One of the problems with the current dispensation is that in most countries, taxpayers provide banks with involuntary and almost cost-free insurance against their recklessness. An insurance fee would make this implicit guarantee explicit. Levying it on a global basis would limit the scope for arbitrage. Meanwhile, clawing back some money from the banks might help address the financial sector's lack of public legitimacy. There might be technical difficulties. But similar funds already exist or are contemplated on a national basis. Sweden introduced a so-called stability fee in 2008, which is levied on all bank liabilities. President Obama has proposed a similar (if temporary) levy on large banks in the US.

But if an insurance fee is practical, it represents only a partial solution to the question of bank reform. It is not clear that it could be introduced on a big enough scale to make a difference. The size of the Swedish stability fund will reach only 2.5 per cent of GDP. The total write-downs in the global crisis between 2007 and 2010 have been estimated by the International Monetary Fund at 4 per cent of world GDP. And that, of course, excludes the broader social costs of financial crises. Moreover, insurance is only one mechanism for dealing with reckless banks, and arguably the less important one. What is needed is to change behaviour in a way that makes banks safer. Insurance alone does not achieve this - we must regulate the risks that banks can take on and wind them down in extremis.³³

In response to the President's announcement, Gordon Brown said this showed that "the proposals that I made at St Andrews for an international levy ... are now gaining currency around the world".³⁴ Following this, at Prime Minister's Questions on 10 February Mr Brown said, "I believe that over the next period we will reach agreement on a global financial levy."³⁵ (In the succeeding months the President's proposal gathered little political support - in part, one suspects, because the projected final costs of the 'TARP' programme have shrunk considerably, from the \$700bn initially authorised to something of the order of \$19 bn.³⁶)

³¹ "Can banks save the planet?", *BBC News online: Peston's picks*, 16 December 2009

³² US Treasury press notice TG-506, *Financial Crisis Responsibility Fee*, January 14, 2010

³³ "Editorial: Brown's global tax rears its head again", *Financial Times*, 12 February 2010

³⁴ "Brown says the world is coming round to bank insurance tax", *Times*, 26 January 2010

³⁵ HC Deb 10 February 2010 c912

³⁶ Congressional Budget Office, [Report on the Troubled Asset Relief Program](#), March 2011

In turn, a large number of charities, unions and church groups have collaborated to launch a campaign in early 2010 for a Tobin tax to “bolster crucial public services in the UK, save lives and reduce poverty overseas, and help pay the bill for tackling climate change.”³⁷ The ‘Robin Hood Tax’ campaign proposes a tax set at 0.05% on “speculative trading”, which, it suggested, could raise something in the order of £250bn a year internationally.³⁸ The campaign’s case was set out in a little more detail on their website, from which the following is taken:

How does it work?

Ten years ago it was felt that a financial transaction tax was too complex to collect. But a lot has changed in the last decade, as banks have improved their IT infrastructures (such as the Real Time Gross Settlement – RTGS) to help drive down trading costs. The 0.5% Stamp Duty paid on shares on the London Stock Exchange is one of many taxes on financial transactions now in place. So the Robin Hood Tax would be applied wherever a transaction takes place. Currently, the vast majority of financial transactions take place on regulated exchanges in financial centres like New York, London and Tokyo. And though the details of how to tax Over The Counter transactions have yet to be finalised – as these currently occur between financial institutions, without the official exchange being involved – the bank licence system could be changed to ensure that these trades do take place within financial exchanges.

Will the tax be passed on to consumers?

The Robin Hood Tax will not impact on personal banking or on retail banking. That’s because it targets a distinct area of bank operations – high-frequency large-volume trading, undertaken by financial institutions in the ‘casino economy’. If you change money to go on holiday, send remittances abroad, invest in a pension fund or take out a mortgage, you will not be affected by this tiny tax.

Can the financial sector afford to pay it?

Although 0.05% is a tiny tax, \$400 billion is a substantial amount. We recognise that even such a small tax will have an effect on the market. Economists such as Schmidt³⁹ have estimated that at a rate of 0.005% currency markets may shrink by 14%. This is due in part to the fact that the margins on some speculative trades are extremely low and these may not continue. Banking is the most profitable industry in the world, with profits of \$788 billion in 2006, which have rapidly returned since the financial crisis, and are predicted by some to double by 2016. Banking is 26 times more profitable per employee than the average of all other industries. (Source: McKinsey, [What’s in store for global banking?: McKinsey Quarterly](#), January 2008).⁴⁰

An EDM supporting the campaign was signed by 157 Members,⁴¹ though the campaign has also been criticised for the way it has made its case. Writing in the *Financial Times*, the economist Tim Harford, suggested the campaign showed a “profound lack of curiosity as to whether this tax would be a good idea”:

³⁷ “Letters: Robin Hood tax offers way to deal with our pressing problems” & “Tax Actually – Curtis and Nighy back levy on bankers to help world’s poor”, *Guardian*, 10 February 2010

³⁸ The campaign cites, among other studies, Stephan Schulmeister, [A General Financial Transaction Tax: A Short Cut of the Pros, the Cons and a Proposal](#), Austrian Institute of Economic Research (WIFO Working Paper 344), October 2009

³⁹ Professor Rodney Schmidt of the North-South Institute, Canada – ie, [The Currency Transaction Tax: Rate and Revenue Estimates](#), United Nations University, 2008. Professor’s Schmidt’s work is also cited by, TUC et al., [Taxing Banks: a report submitted to the IMF](#) February 2010 p24.

⁴⁰ “How it works: the big idea”, [Robin Hood Tax](#), retrieved 6 April 2010

⁴¹ EDM 913 of 2009-10, 23 February 2010

Start with the claim on the Robin Hood tax website that this is a “tiny tax on bankers ... the people who caused this mess”. First, it’s not a tax on bankers. It’s a tax on financial transactions. And it’s not necessarily tiny, because some worthwhile financial transactions have a very large face value, and a much smaller true value. For instance, I might buy car insurance which could – if I knocked somebody down and permanently disabled them – trigger a payment of £1m. My insurance company might want to reinsure that million-pound risk, a perfectly sensible, socially useful and non-speculative transaction. But at a “tiny” tax rate of 0.05 per cent, that’s a £500 tax on a face value of £1m. It’s hard to imagine such a tax wouldn’t somehow affect my premium. The Robin Hood tax proposes to raise several hundred billion pounds, and it will ultimately be paid not by “bankers” but by all of us, with the burden shared unpredictably. Robin Hood himself seems incurious where his arrows will strike, or at least unwilling to be specific.⁴²

For its part, the Labour Government suggested that many questions about the potential impact of this type of tax remain unanswered. Responding to a debate in Westminster Hall in March, the then Financial Secretary, Stephen Timms, said:

We would need to know, for example, the impact of such a tax on the transactions being taxed and what that would mean for the financial sector more widely and for growth in the economy. How would we ensure that financial transactions did not simply evolve into non-taxed forms, which would defeat the purpose of the tax in the first place? We see that in other contexts when taxes are introduced. One key principle set out by the Prime Minister in November involved economic distortion. If we go down the road of imposing such a tax, we must ensure that there are no unintended consequences that might lead to economic distortions with a damaging impact overall on the economy. We must ensure that in attempting to solve one problem, we do not create another somewhere else.⁴³

In early March before the Labour Government’s Budget, the then Prime Minister gave a speech on the economy the same day when he suggested any international agreement would be based on ‘four key elements’:

First, that a levy on banks seems likely to be the most practical approach. Second, that the levy should be designed go with the grain of necessary regulatory reform not cut across or remove the need for it. Third, that the levy should support globalisation and avoid double-taxation of international banks. And finally that proceeds should be for national governments to use, whether to put them aside in a dedicated insurance fund, to repay interventions or to reduce public debt.⁴⁴

The 2010 Budget report said a little more on the principles which, in the Labour Government’s view, should underpin such a ‘systemic risk tax’:

There are several key principles that the Government believes should guide further international work on systemic risk taxes:

- first and foremost, a systemic risk tax should be coordinated internationally to minimise competitive distortions, and issues of double-taxation and arbitrage risk will need to be resolved;

⁴² “If that’s the Robin Hood tax, I’m the sheriff of Nottingham”, [Financial Times](#), 20 February 2010

⁴³ HC Deb 10 March 2010 c137WH

⁴⁴ 10 Downing Street press notice, *Prime Minister’s speech on the economy*, 10 March 2010 – see also, “Brown retreat dents hopes for Tobin tax”, [Financial Times](#), 11 March 2010

- a systemic risk tax should complement but not substitute for existing G20 regulatory initiatives aimed at addressing systemic risk. The work of the Financial Stability Board (FSB) on both reducing the probability and impact of an individual firm's failure, and on streamlining the process of dealing with failures if they nevertheless occur, remains of vital importance;
- while internationally coordinated, the proceeds of such a tax should be for national governments to use. A systemic risk tax should not be seen as an insurance policy to benefit individual institutions, shareholders or creditors. To minimise moral hazard the proceeds of such a tax should go into general taxation rather than a stand-alone fund;
- calibration and implementation must take account of the wider regulatory reform programme and the cumulative impact of all reforms to strengthen financial stability, as well as the timing and strength of the economic recovery to ensure that the impact of any tax is proportionate and measured;
- the tax base should be as simple as possible, to minimise arbitrage and help international replicability, while taking account of the characteristics of a firm's business that give rise to systemic risk. In particular it should take into consideration size, interconnectedness, and substitutability, while accepting that a precisely calibrated measure might not be achievable; and
- a systematic risk tax should cover all financial institutions that might contribute significantly to systematic risk, to address level-playing field concerns and minimise arbitrage.⁴⁵

The report went on to note that the UK would “continue to work closely with the G20 and IMF on the development of this and other proposals, and will seek agreement on a process to coordinate further work internationally.”⁴⁶

4 Recent developments

4.1 Assessment by the IMF & discussion at the G20

Over the last year there has continued to be a lot of interest in the possibility of Tobin-like taxes, but little sign of any international agreement about their introduction.

In April 2010 the IMF released an interim report for the G20 on the possible introduction of both a flat rate levy on banks, and a tax on their activities, based on both profits and pay.⁴⁷ The report's executive summary summarised the two taxes as follows:

A “Financial Stability Contribution” (FSC) linked to a credible and effective resolution mechanism. The main component of the FSC would be a levy to pay for the fiscal cost of any future government support to the sector. This component could either accumulate in a fund to facilitate the resolution of weak institutions or be paid into general revenue. The FSC would be paid by all financial institutions, with the levy rate initially flat, but refined over time to reflect institutions' riskiness and contributions to systemic risk—such as those related to size, interconnectedness and substitutability—and variations in overall risk over time.

⁴⁵ HC 451 March 2010 p37

⁴⁶ HC 451 March 2010 para 3.10

⁴⁷ “IMF proposes two big new bank taxes to fund bail-outs”, BBC News online, 21 April 2010

Any further contribution from the financial sector that is desired should be raised by a “Financial Activities Tax” (FAT) levied on the sum of the profits and remuneration of financial institutions, and paid to general revenue.

The report went on to note:

International cooperation would be beneficial, particularly in the context of cross border financial institutions. Countries’ experiences in the recent crisis differ widely and so do their priorities as they emerge from it. But none is immune from the risk of a future—and inevitably global—financial crisis. Unilateral actions by governments risk being undermined by tax and regulatory arbitrage. Effective cooperation does not require full uniformity, but broad agreement on the principles, including the bases and minimum rates of the FSC and FAT. Cooperative actions would promote a level playing field, especially for closely integrated markets, and greatly facilitate the resolution of cross-border institutions when needed.⁴⁸

The report went on to argue that a Tobin-like tax would not prevent financial instability and would be too easy to pass on to customers – although the administration of this kind of charge was not a fundamental obstacle:

Collecting taxes on a wide range of exchange-traded securities (and, possibly, derivatives) could be straightforward and cheap if withheld through central clearing mechanisms, as the experience with the UK stamp duty [set at 0.5% on locally-registered shares] shows. Certainly the widespread use of a few clearance and settlement systems is helpful for the implementation of transaction taxes more generally. Of course, some important practical issues are not yet fully resolved. Questions remain, for example, as to whether such a tax might drive transactions into less secure channels. But implementation difficulties are not unique to [a tax on financial transactions: the FTT], and sufficient basis exists for practical implementation of at least some form of FTT to focus on the central question of whether such a tax would be desirable in principle ...

[However] ... **an FTT does not appear well suited to the specific purposes set out in the mandate from G-20 leaders** ...

It would ***not be the best way to finance a resolution mechanism*** of the kind discussed above, since the volume of transactions is a poor proxy for either the benefits it conveys on particular institutions or the costs they are likely to impose on it.

It is ***not focused on core sources of financial instability***. An FTT would not target any of the key attributes—institution size, interconnectedness, and substitutability—that give rise to systemic risk. (Adjusting the rate of tax to reflect such considerations would be possible in principle, but highly complex in practice; more generally, if the aim is to discourage particular types of transactions, this could be done more effectively by taxing or regulating them directly) ...

Its ***real burden may fall largely on final consumers rather than, as often seems to be supposed, earnings in the financial sector***. No doubt some would be borne by owners and managers of financial institutions. But a large part of the burden may well be passed on to the users of financial services (both businesses and individuals) in the form of reduced returns to saving, higher costs of borrowing⁴⁹ and/or increases in final

⁴⁸ IMF, *A fair and substantial contribution by the financial sector: Interim Report for the G20*, April 2010 p3

⁴⁹ Schwert and Seguin (1993), for example, estimate that a 0.5 percent securities transactions tax in the U.S.

commodity prices. Indeed, this is more likely the more general the adoption of the tax, since that helps industry pass on the cost to its customers.

Because it is levied on every transaction, the cumulative, 'cascading' effects of an FTT—tax being charged on values that reflect the payment of tax at earlier stages—can be significant and non-transparent. It is far from obvious that the incidence would fall mainly on would increase the cost of capital by 10–180 basis points. either the better-off or financial sector rents.⁵⁰ In sum, while the incidence of an FTT remains unclear—as with other taxes considered in this report—it should not be thought of as a well-targeted way of taxing any rents that may be earned in the financial sector.⁵¹

Initial reactions to the report were strongly divided, with the UK and US reportedly positive about these ideas, while other countries, such as Canada and Japan, being ambivalent at best, if not strongly opposed.⁵²

Following this in January 2011, the French Government announced it would seek to promote the international adoption of a financial transactions tax, as part of its Presidency of the G20. One of the aims of its Presidency is “working on behalf of development”, and as part of this, the Government stated it would “bring discussions on development financing to G20 level, via innovative financing and in particular a tax on financial transactions.”⁵³ In a speech President Sarkozy gave at this time, he said, “France considers that this tax is morally sound, given the financial crisis we have just been through, that this tax is useful to dissuade speculation ... and that this tax is effective for finding new resources for development.”⁵⁴ However, there has been little sign that the G20 has reached any consensus on the issue, even with a recent campaign by economists from several countries supporting reform.⁵⁵

4.2 The UK's Bank Levy

In its June 2010 Budget, the Coalition Government announced that a new bank levy would be introduced from January 2011: the levy would be based on banks' balance sheets, and is intended to encourage banks to move to less risky funding profiles. When the Chancellor, George Osborne, described the new levy in his Budget statement to the House, he also said that the Government would explore the merits of a tax on financial activities, while noting that this type of reform was dependent on achieving international consensus for such a tax:

The failures of the banks imposed a huge cost on the rest of society, so I believe that it is fair and right that in future banks should make a more appropriate contribution, reflecting the many risks that they generate. Such an approach has already been recommended by the International Monetary Fund. We are exploring the costs and benefits of a financial activities tax on profits and remuneration, and we will work with international partners to secure agreement, but today the British Government take the initiative in this global debate about the appropriate risks and rewards in international banking.

⁵⁰ Most current proponents of an FTT do not envisage that its base would include current account bank transactions, but it is cautionary to recall that while some had advocated this as a relatively progressive form of taxation, such evidence as there is suggests the opposite: Arbeláez, Burman, and Zuluaga (2005).

⁵¹ *A fair and substantial contribution by the financial sector ...*, April 2010 pp15-17

⁵² “IMF puts forward plans for two global bank taxes” & “Nations struggle to find consensus on bank taxes”, *Financial Times*, 21 & 24 April 2010

⁵³ G20, [Presentation of the French Presidency of the G20 & G8](#), 14 January 2011 p4

⁵⁴ G20, [Address by Mr Nicolas Sarkozy to present the presidency of the G20 and G8](#), 14 January 2011

⁵⁵ [“Robin Hood tax: 1,000 economists urge G20 to accept Tobin tax”](#), *Guardian*, 13 April 2011

From January 2011, we will introduce a bank levy. It will apply to the balance sheets of UK banks and building societies, and to the UK operations of banks from abroad. There will be deductions for tier 1 capital and insured retail deposits, and a lower rate for longer maturity funding. Smaller banks with liabilities below a certain level will not be liable for the levy. Once fully in place, we expect the levy to generate over £2 billion of annual revenues.

There are those who have argued whether we should wait until every country in the G20 introduces a bank levy. I believe that is not reasonable or fair. Indeed, I can tell the House that the French and Germans have joined the UK today in committing to introduce a bank balance sheet levy. In a joint statement, our three Governments have pledged to ensure our banks make a fair contribution to reflect the risks they pose.⁵⁶

The Government anticipated that the levy could raise £2.32 billion by 2012/13.⁵⁷ (The design of the levy was subject to consultation over 2010, though its yield is still expected to be of this size.⁵⁸) Some commentators contrasted the expected receipts from the levy from the much larger sums which supporters of the Robin Hood Tax campaign believe that Tobin taxes would deliver: as the Guardian's economics editor, Larry Elliott noted:

The sense that the budget was less fair than it looked was underlined by the soft-touch approach to the City. The increase in capital gains tax was smaller than expected and the £2bn bank levy was hardly suitable punishment given the role of the financial sector in Britain's most grievous post-war recession. Campaigners for a so-called Robin Hood tax said Osborne could have raised £20bn through a financial transaction tax - enough to pay for the £12bn he will raise from pushing up VAT to 20% with plenty to spare.⁵⁹

However, it appears that many governments find these claims unconvincing. In June 2010 finance ministers from the G20 nations met in Korea, and the summit's final communiqué was lukewarm on the issue, stating:

[We] agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution. To that end, recognizing that there is a range of policy approaches, we agreed to develop principles reflecting the need to protect taxpayers, reduce risks from the financial system, protect the flow of credit in good times and bad, taking into account individual country's circumstances and options, and helping promote level playing field.⁶⁰

As the *Financial Times* reported, the rather bland language used was indication of a serious division of opinion between countries:

There was a moment in the spring when the idea of a uniform global levy on banks was fashionable ... But at the Group of 20 meeting of finance ministers and central

⁵⁶ HC Deb 22 June 2010 cc 175-6

⁵⁷ *Budget 2010* HC 61 June 2010 p40

⁵⁸ For more details see, [Taxation of banking, Library standard note SN05251](#), 19 July 2011.

⁵⁹ "Emergency budget 2010: The axeman cometh", *Guardian*, 23 June 2010

⁶⁰ G20, *Meeting of Finance Ministers and Central Bank Governors, Busan, Republic of Korea*, 5 June 2010. At a summit in Toronto later that month, the G20 nations noted that there were "a range of policy approaches to" making sure the financial sector made a "fair and substantial contribution ... Some countries are pursuing a financial levy. Other countries are pursuing different approaches." (G20, *The G-20 Toronto Summit Declaration*, 26/27 June 2010 para 21)

bank governors in Busan, South Korea, this month, the chances of agreement on a global banking levy faded away in a marathon negotiating session that lasted until 5am. The opposition, led by Canada but supported by Australia, Japan, China and other emerging economies in the G20, ensured that there will be no deal in Toronto, nor at the Seoul summit in November. Jim Flaherty, Canada's finance minister, told reporters: "The debate on ... bank levies has been a distraction from the core issues and it has been apparent again from our meetings that most of the G20 members do not support the concept of a universal levy." ...

The communiqué attempted to disguise the rift that had occurred and the end of the road for a uniform global banking levy. It stated that there was "a range of policy approaches" that countries would adopt to protect taxpayers, but added that this range would be determined "taking into account individual countries' circumstances and options". Officials made it clear that the language implied countries had leeway to do what they liked.

The G20 did nevertheless agree that where taxpayers have had to support banks, the principle should be that the financial sector should pay that money back. The finance ministers' communiqué stated: "The financial sector should make a fair and substantial contribution to-wards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution." ... Such is the political need in many countries to have a punitive tax on banks that the US, UK, Germany and much of the European Union still want individual banking levies ... The result of the wrangling is that countries are still going ahead with their plans but few expect any banking levy to be large or to raise a significant sum ... Given the opposition of Canada, the Toronto summit is highly unlikely even to make progress on resolving the remaining difficulties of introducing voluntary banking levies where countries agree on their merits.⁶¹

For its part the IMF had produced a further report on financial taxes to aid these discussions,⁶² and in this the authors raised concerns about the impact that a tax on financial transactions might have:

No doubt some would be borne by owners and managers of financial institutions. But a large part of the burden may well be passed on to the users of financial services (both businesses and individuals) in the form of reduced returns to saving, higher costs of borrowing and/or increases in final commodity prices. Indeed, this is more likely the more general the adoption of the tax, since that helps industry pass on the cost to its customers. Because it is levied on every transaction, the cumulative, 'cascading' effects of an FTT—tax being charged on values that reflect the payment of tax at earlier stages—can be significant and non-transparent. It is not obvious that the incidence would fall mainly on either the better-off or financial sector rents. In sum, while the incidence of an FTT remains unclear—as with other taxes considered in this report—it should not be thought of as a well-targeted way of taxing any rents earned in the financial sector.⁶³

Given this the authors reiterated the case, made in their interim report, that it would be preferable for governments to impose some form of fixed levy, to compensate taxpayers for the support they had provided the banking system, and/or a tax on financial activities. In light

⁶¹ "An idea that was hot, but now is not", *Financial Times*, 25 June 2010

⁶² The paper, published in June, is collated with other material in, [Financial Sector Taxation - The IMF's Report to the G-20 and Background Material](#), September 2010

⁶³ *op.cit.* pp18-19

of this work, the Treasury set out the UK's position on 'Robin Hood' taxes in a statement on their site:

The Government is aware that there is a strong lobby for the creation of a financial transactions tax (FTT) that would see a small fee imposed on trades in various financial asset classes to raise money to pay for overseas development assistance, climate change or to help tackle the current budget deficit. Foremost amongst these proponents has been The Robin Hood Tax campaign.

The Government also thinks that it is right for banks to make a contribution to the public purse. The International Monetary Fund (IMF) has recently published their report, A Fair and Substantial Contribution by the Financial Sector, which was commissioned by the G20. The report endorses the type of bank levy model that the UK recently announced at its Emergency Budget on 22nd June and which the Chancellor has made clear will be implemented in the UK with effect from the beginning of next year. The Levy offers an effective way forward and ensures that banks make a contribution in respect of the risks they pose to the UK financial system and wider economy. The report also endorses a Financial Activities Tax (FAT) levied on the sum of certain profits and remuneration in the financial sector. As announced in the Emergency Budget we are currently examining the costs and benefits of a FAT and will continue to work with international partners monitoring developments in this area. However, the report doesn't offer an endorsement of a FTT and clearly there would need to be further discussion around whether the FTT model offers a stable and efficient mechanism.

The Government remains totally committed to the international development agenda. The UK remains on target to reach its international commitment for Overseas Development Assistance of 0.7% of Gross National Income, an important commitment for the Coalition Government.⁶⁴

4.3 Proposals for a new tax by the European Commission

In October 2010 the European Commission published an assessment of the options for taxing the financial sector⁶⁵ – and in the accompanying staff working document, the authors suggested that, “given the complexity of some financial transactions, the impact of a transaction tax and the feasibility of such a tax remain largely uncertain in many cases. Given this complexity, there may be considerable unintended effects and the possibilities of circumvention of the tax increase with the complexity of the operation.”⁶⁶ Further to this the authors addressed the issue of the incidence of this type of tax – which, clearly, would be critical to its final impact:

Tax Incidence – Would the Financial Sector carry the burden?

There is no empirical evidence on the real incidence of a FTT. Transactions taxes are under the political and public spotlight because they are perceived as a contribution of the highly speculative financial institutions to the costs of the financial crisis. However, there is often a difference between the legal tax payer (legal incidence) and the economic agent who actually carries the economic burden of a tax (economic

⁶⁴ HM Treasury, [Robin Hood Tax](#), 4 August 2010

⁶⁵ The Commission's work on this issue is collated at:

http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm

⁶⁶ [SEC\(2010\) 1166/3](#) p14

incidence). In the context of a Financial Transactions Tax, the economic incidence of the tax could fall either on traders, on stock exchanges, on companies and governments (via higher capital costs) or on final consumers via higher prices for financial services.

For evaluating the distributional aspects of the tax, a starting point is to analyse whether the tax is progressive (i.e. it taxes the rich proportionally more than the poor or less wealthy). Unfortunately, such empirical analyses are currently unavailable, because of a lack of data. It is often argued that the tax could potentially have progressive properties since rich people are supposed to hold, and therefore trade, more than poorer ones. However, it cannot be taken for granted that this assumption necessarily holds since it also concerns the activities of financial intermediaries such as pension funds, which also manage the savings of middle- and lower-income earners.⁶⁷

The Commission's report was the subject of a debate in the House in February 2011.⁶⁸ During the debate the Financial Secretary, Mark Hoban, suggested that a tax might well have a detrimental impact on the UK's financial sector if introduced unilaterally – taking issue with Kelvin Hopkins, who had argued in favour of this reform:

The hon. Member for Luton North has suggested that a financial transaction tax would not be distorting. It is worth focusing on that: he argues that it would cause little distortion because it would be levied at a low rate on a broad base. Such an argument is not persuasive, however, according to the IMF. If the central principle—the sole policy objective—is to raise revenue, taxing transactions between businesses, which is what many financial transactions are, is unwise. Distorting business decisions reduces total output, so more could be raised by taxing output directly. A tax levied on transactions at one stage cascades into price at all further stages of production ...

In the UK financial services sector, processing centres are a source of employment. Such centres employ people who process the transactions that are booked here—such as JP Morgan Chase in Bournemouth, Deutsche Bank in Birmingham, Citibank in Belfast, and others. They process transactions on a global basis and their employees are drawn from the local work force. Such people are not necessarily earning high incomes—they are not fat cats. A direct employment benefit comes from processing those transactions here, but the hon. Gentleman argues for a tax that would drive those jobs and transactions offshore.⁶⁹

The Minister said a little more on the issue at the report stage of the Finance Bill on 5 July, when John McDonnell MP put down an amendment to require the Government to produce a review on such a tax; in resisting the amendment Mr Hoban argued that there was “sufficient work going on to explore the issue in significant detail”; an extract from his speech is given below:

The hon. Member for Hayes and Harlington ... is right to highlight the importance of funding international development, on which there is cross-party consensus. The Government agree that we should move to ensure that 0.7% of gross national income should be for aid. The hon. Gentleman is also right to highlight the importance of achieving the millennium development goals. ... These are important issues, but we need some discussion about whether the financial transaction tax model offers a stable

⁶⁷ *op.cit.* p15

⁶⁸ [European Committee B, 7 February 2011](#)

⁶⁹ *op.cit.* cc19-20

and efficient mechanism to raise revenue. Such taxes remain the subject of ongoing debate at international level, and the UK continues to take an active role in the discussions.

The hon. Gentleman called for a review. There is no shortage of reviews on the issue. The IMF has had a review and the EU has had reviews, but they all come back to the fundamental problem with the proposal: a tax would need to be applied globally to prevent the relocation of financial services. If implemented only at UK or EU level, the tax would simply prompt the relocation of financial services, and so fail to deliver the desired outcome in terms of revenue. In doing so, it would have significant adverse impacts on employment and the wider economy ...

The European Commission is due to publish an impact assessment on further financial sector taxation, including transaction taxes, in the next few months. The House will be aware that, ahead of this, the Commission last week published its latest communication on the EU budget. This proposes that the EU budget could in future be part-funded through new taxes, including a financial transaction tax. I hope the House is also aware that this Government's position is clear: we oppose any new EU taxes to fund the EU budget.

... We have not ruled out a financial activities tax. We are engaged in discussion with our international partners and we have pressed for the Commission to consider such a tax. It is working on that. We are making progress. Another review is not needed; there is sufficient work going on to explore the issue in significant detail.⁷⁰

In September the Commission published proposals for a financial transactions tax, to apply to "all transactions on financial instruments between financial institutions when at least one party to the transaction is located in the EU." The Commission set out its rationale for the new tax, and gave details of its scope and projected yield, in a press notice and accompanying memo:

The Commission has decided to propose a new tax on financial transactions for two reasons.

- First, to ensure that the financial sector makes a fair contribution at a time of fiscal consolidation in the Member States. The financial sector played a role in the origins of the economic crisis. Governments and European citizens at large have borne the cost of massive taxpayer-funded bailouts to support the financial sector. Furthermore, the sector is currently under-taxed by comparison to other sectors ...
- Second, a coordinated framework at EU level would help to strengthen the EU single market. Today, 10 Member States have a form of a financial transaction tax in place. The proposal would introduce new minimum tax rates and harmonise different existing taxes on financial transactions in the EU. This will help to reduce competitive distortions in the single market, discourage risky trading activities and complement regulatory measures aimed at avoiding future crises. The financial transaction tax at EU level would strengthen the EU's position to promote common rules for the introduction of such a tax at global level, notably through the G20.

The revenues of the tax would be shared between the EU and the Member States. Part of the tax would be used as an EU own resource which would partly reduce

⁷⁰ HC Deb 5 July 2011 cc 1419-20. The Minister reiterated the position briefly in a written answer a few days later: HC Deb 11 July 2011 c24W.

national contributions. Member States might decide to increase the part of the revenues by taxing financial transactions at a higher rate.⁷¹

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How will the tax work?

Who will be taxed?

The main taxpayers would be financial institutions operating financial transactions, i.e. banks, investment firms, other financial institutions like insurance companies, stockbrokers, pension funds, undertakings for collective investment in transferable securities, alternative investment funds like hedge funds, etc.

Which transactions will be covered?

The Commission has proposed that the tax would be levied on all transactions on financial instruments between financial institutions, if at least one of the financial institutions was deemed to be established in the European Union. The financial instruments in question would be products such as shares, bonds, derivatives and structured financial products. Whether transactions were carried out on organised markets or over the counter would not make any difference - in both cases they would be taxed.

Which transactions will be excluded from the proposed tax?

Only transactions related to financial instruments would be covered by the Commission's proposal. This means all transactions in which private households or SMEs were involved would fall out of the scope of the tax. For instance, house mortgages, bank borrowing by SMEs, or contributions to insurance contracts would not be included. Spot currency exchange transactions and the raising of capital by enterprises or public bodies, including e.g. public development banks through the issuance of bonds and shares on the primary market, would not be taxed either ...

Which tax rates will be proposed?

In order to reduce the risk of market disruptions, the Commission has proposed to impose a very low tax rate on transactions. It has proposed a minimum tax rate for the trading of bonds and shares of 0.1% and 0.01% for derivative products. Member States would be free to apply higher rates. The tax would have to be paid by each party to a transaction...

How will the revenue be collected?

The tax would be paid immediately by financial institutions to Member States on the basis of the transactions undertaken, before netting and settlement. These are normally electronic transactions, in which case the tax would be paid the same day it was due. If the transaction is not processed electronically, the financial transaction tax would be due within three working days so as to allow the manual processing of transactions while avoiding unjustifiable cash-flow advantages.

The financial institutions that are liable to pay the financial transaction tax would have to submit a return to tax authorities. Member States would have to take appropriate measures to prevent tax evasion. Measures would include registration of financial institutions, accounting and reporting to ensure payment, keeping relevant data on financial transactions at the disposal of tax authorities and verifying the correct payment of the tax.

Are there estimates of how much money could be raised?

At a rate of 0.1% for bonds and shares and 0.01% for other kinds of transactions such as derivatives, the tax could raise approximately € 57 billion per year.⁷²

⁷¹ European Commission press notice IP/11/1085, *Financial Transaction Tax: Making the financial sector pay its fair share*, 28 September 2011

⁷² European Commission MEMO/11/640, *Common Rules for a Financial Transaction Tax – Frequently Asked Questions*, 28 September 2011

As one would have expected, the Commission's proposals were strongly welcomed by campaigners for a 'Robin Hood' tax, and criticised by financial and business groups.⁷³ Writing in the *Financial Times*, the columnist John Pender argued that there was evidence that a well-designed levy could raise money, without undermining the financial sector, citing the UK's experience in charging stamp duty on stocks and shares:

[The case against a Tobin tax] starts with the suggestion that the tax would impair market efficiency and be passed on to financial institutions' customers rather than being borne by banks. Then there is the concern that, in the absence of full international agreement, transactions would indeed migrate to less Tobinesque territory. Critics point to the Swedish experience of taxing equity and bond transactions between 1984 and 1991, which caused a dramatic decline in trading volumes and an exodus of business to London.

Yet this overlooks the fact that Britain already has a financial transactions tax - stamp duty - in place since 1694. This has signally failed to prevent London's ascendancy in international finance. A reduction in financial trading volumes might anyway be no bad thing. The huge increase in bank balance sheets over the past two decades is primarily the result of the growth of trading between financial institutions, as opposed to lending to businesses and households. The social utility of much of this activity has been rightly questioned and trade in structured products has, as we know, been a systemic catastrophe.⁷⁴

An editorial in the paper argued that the comparison between the UK's tax on shares and a Tobin tax was flawed, and that, as indicated by the IMF, there were better options when taxing the financial sector to charging a levy on transactions:

Transaction taxes are neither as self-defeating as some opponents claim nor as straightforward to put in place as proponents think. Many point to the UK stamp duty on share transactions as proof that Tobin taxes are feasible. But stock trading in the City of London has a centuries-old first-mover advantage and a largely captive market for sterling equity financing. Both discourage avoidance. Other transactions are more footloose. Trading venues for entirely new products may well take transaction taxes into account when deciding where to set up shop.

Still, it is true that financial transactions require a clearing venue and a legal system enforcing contracts - something offshore jurisdictions cannot provide without the big economies' blessing. But without US support - which does not exist - the EU will struggle to impose a transaction tax on, say, derivatives unless it throws up transatlantic barriers amounting to a financial trade war.

Even if Tobin taxes could be made to work, they would do little good. Most purposes they are supposed to achieve are better pursued with other taxes. If the point is to tax banks and other financials more heavily, there are less distorting and less avoidable forms of taxation. One is to tax financial companies' balance sheets, as the UK's bank levy does. Another is to follow the International Monetary Fund's suggestion of a "financial activities tax" levied on the sum of compensation and profits - a measure of

⁷³ "Business lashes out at trading tax plans", *Financial Times*, 29 September 2011

⁷⁴ "Long-term investors would benefit from Tobin tax", *Financial Times*, 28 September 2011

the value added of the financial sector which, scandalously, escapes value added tax in countries that levy it on everyone else.⁷⁵

To date there has been no discussion of the proposals by European Finance Ministers, though there have been some concerns about how financial institutions might pass on the tax, or avoid it altogether:

When José Manuel Barroso, the European Commission president, proposed introducing a tax on financial transactions in Europe, it was clear whom he had in his sights. "It's a question of fairness," he said as he unveiled the proposal in Strasbourg last week. "It is time for the financial sector to make a contribution back to society." But bankers, analysts and investors point out that, instead of banks, such a tax would be likely to hit pension funds and other "long-only" savings vehicles and middle-sized companies that use derivatives to hedge against swings in commodity prices and currencies, because they would be the least able to avoid it.

According to bankers and corporate executives, Mr Barroso's stated target, the banks, will probably be able to pass much of the cost on to their customers and shift their internal hedging transactions out of Europe. Multinational companies may also be able to shift their transactions to offshore subsidiaries to avoid the tax. High-frequency traders, one of the main targets of the proposed legislation, would likely move offshore and shift more of their transactions from equities and bonds, which would be taxed at 0.1 per cent, to contracts for difference and derivatives, which would be taxed at 0.01 per cent ...

Manfred Bergmann, a European Commission official, says that the risks of avoidance were overstated. "We think now we have a design which leads to the closure of loopholes," he says. But the Commission's own impact study suggests that between 70 and 90 per cent of derivatives trading would be wiped out or displaced outside the 27-nation bloc. "If the transaction tax is applied as it is now envisioned, the UK as a financial centre dies," says a top London-based executive at a global bank.

As noted in this extract, the Commission has published an impact assessment on the tax, and in this suggests that it could well reduce the volume of these transactions significantly:

The introduction of additional taxes bears the intrinsic risk of agents relocating their activities to reduce the fiscal burden. Relocation might take place by moving the relevant activities to jurisdictions where they are taxed less, or by shifting to products/suppliers outside the scope of taxation within the same jurisdiction. In principle, this might even lead some products/markets to disappear in the medium and longer run. Obviously, the risk of physical relocation of markets/market players and migration to non-taxed products increases the less widespread is the adoption of the taxes and the narrower their scope. Thus, the concrete design of a tax in combination with the transaction costs of relocation will largely impact on the actual extent of relocation. The cases of Sweden and the UK, which both introduced a tax on financial transactions with different relocation effects, provide some evidence for this ...

To the extent that financial transactions are more mobile than financial companies, taxing institutions that carry trade on the basis of the residence principle could mitigate

⁷⁵ "Editorial: Europe's search for a silver bullet; Proposal for Tobin tax is populist, not productive", *Financial Times*, 29 September 2011. The paper's letters section carried an exchange of views on the Commission's proposals over the next few days: "Europe needs to put flawed Tobin tax to rest" & "Transaction tax would curb useless high-frequency trades", 30 September; "FTT – fiscal and financial suicide", 1 October 2011; "Think globally on transaction tax", 3 October 2011.

relocation risks compared to taxing transactions at source or at the place of issuance. For example, under the residence principle, a financial company located in a country that applies the FTT would be taxed on its operations irrespective of where these transactions take place (if applied on a worldwide basis).⁷⁶

Against this background, it is difficult to make unequivocal conclusions on the exact size of the elasticities and relocation risks (although there are strong risks of relocation). Our revenue simulations consider a relocation of securities markets by 10%, a relocation of spot currencies by 40% and a relocation of derivatives instruments of 70% or 90% ... Relocation here reflects both the move of activities elsewhere outside of the taxing jurisdiction and the disappearance of some types of activities. Such disappearance could be seen as positive if the activities targeted are considered as harmful. To the extent that High-Frequency Trading is considered as harmful, one has to bear in mind it is estimated to be about 40% of total transactions.⁷⁷

Writing to the *Financial Times*, Stuart Fraser, Policy Chairman at the City of London Corporation, argued that the scale of this potential change meant that only an international tax would be workable

Sir, While the unintended consequences of a European financial transaction tax are worrying ("Warning of unintended outcomes with Tobin tax plans", October 6), the consequences set out in the European Commission's own impact assessment - that between 70 per cent and 90 per cent of all derivatives trading could move outside of the European Union and that, consequently, the tax could cost more than it raises - should remain the overriding concern for European policymakers.

Put simply, how can you tax something that is no longer here?

Maintaining a thriving financial services industry and a network of global financial centres generates huge benefits for each of the 27 EU member states and has an important role to play in facilitating the broader economic growth that every European leader has identified as a priority.

Clearly, with most of the revenues coming from the UK, a European FTT would be more of a tax on London than on the EU. However, the City is a huge asset for the EU as a whole and the impact of any such measure would be felt right across the Union. That is why, if European policymakers truly feel that a transaction tax is vital to shoring up our financial system, they must - as the UK government has already made clear - seek to create a global consensus through the Group of 20.

Stuart Fraser,
Policy Chairman, City of London Corporation⁷⁸

⁷⁶ There is however still a risk that financial companies open foreign subsidiaries in countries that do not apply the tax and do the trading from these places. The profit made on these transactions could then be repatriated to the parent in the form of dividends.

⁷⁷ European Commission, *Commission Staff Working Paper Impact Assessment SEC(2011) 1102 final*, 28 September 2011 (Vol 1) pp 47-49

⁷⁸ "Letters: How can you tax transactions that are no longer there?", *Financial Times*, 7 October 2011