Factsheet

The Financial Transaction Tax at a Glance

The taxation of financial transactions is back on the agenda. At the G20 summit in Pittsburgh, French President and the German Chancellor were opened the debate on a ***Financial Transaction Tax*** (FTT) in the G20. As a result, the IMF has been mandated to prepare a report by June 2010 on options "*as to how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system.*"

Political momentum for the FTT

The US's *Troubled Asset Relief Program* (TARP) - the $700 billion financial-bailout bill from 2008 - already contains a provision to "*recoup*" from the financial-services industry in case there is a shortfall in the repaying of money. During his election campaign Obama, too, said in a speech in Wisconsin on October 1, 2008: *"I've proposed a Financial Stability Fee on the financial services industry so Wall Street foots the bill -- not the American taxpayer."* As well, members of the US House of Representatives are also considering an FTT. The EU parliament recently has spoken out in favour of the FTT and the *Leading Group on Innovative Financing for Development* - some 40 countries from all continents - has already established an expert group which is working out proposals to be submitted in all important international fora.

In Europe, alongside Sarkozy and Merkel, the president of the European Commission, Barroso, and the head of the British supervisory authority, Turner, have joined the bandwagon. France, Austria and Belgium have also in the past supported the taxation of currency transactions.

This trend offers an extraordinary opportunity for pressure from Civil Society, because Civil Society Organisations have been advocating for a decade for a tax on currency transactions of different types (*Tobin Tax, Spahn Tax, Solidarity Levy to Finance Development*).

The costs of the bail-outs and the stimulus programs that amount to approx. 3,5 trillion USD have lead to a tremendous increase in public debt. In the US net debt will double from 42,3% of GDP in 2007 to 84,9% in 2014. This is an increase of approx. 6 trillion USD. In the UK, the debt burden will almost triple from 38,3% to 91,8%, and in the euro-zone it will increase from 56,2% to 83,7%.[1] This will put extreme pressure on government budgets, and there will be attempts to make citizens pay for the crash through cuts in social spending, environment and other public goods. However, the entire deficit can be paid for by appropriate taxation on those who are responsible for the crisis.

FTT - not the same as the Tobin Tax

In the recent discussion the FTT and the Tobin tax have often been confused. However, there is a difference. Whereas the Tobin proposal refers to currency transactions (i.e. changing money from one currency to another) the FTT envisages a much broader tax base. It would tax transactions of all kinds of financial assets: shares, bonds, securities and derivatives.[2] The optimal solution is to tax all these categories of assets. However, it would be possible to tax just one or two categories.

As the FTT is limited to asset markets, other transfers such s payments for goods or labour market transactions, as well as remittances and short-term inter-bank lending and any operations of the central banks, would not be subject to an FTT.

Unilateral implementation possible

Most politicians, who have recently supported the idea of an FTT have argued that such a tax would only work if it were implemented internationally. This is not true, as

[1] IMF, World Economic Outlook, October 2009

[2] As long as these are traded at a stock exchange or another public institution and not bilaterally between financial actors (so called trade "over the counter" i.e. without any control and supervision). The G20 as well as the EU have declared, that trade "over the counter" should be subject to control in the future, which would also allow to tax it easily.

the existence of such taxes in several countries proves. The most prominent example is the British "*Stamp Duty*." This is a relatively high tax of 0,5% which is levied on the nominal price of any purchase of shares of UK companies. This means that a foreign purchaser has to pay the tax. The tax is also levied on purchases of shares of British firms outside the UK. If the asset is transferred to a clearance service or converted to paper, which avoids the *Stamp Duty*, an "exit charge" of 1.5% has to be paid. The revenue in 2006 was approx. 5 billion euro. The duty has not lead to tax evasion and the weakening of the City of London. In fact, in big financial marketplaces, actors benefit from network externalities (i.e. important partners in proximity, infrastructure etc.). As long as the tax rate does not exceed the costs of relocation, financial institutions would rather pay the tax than move to another location.

Country specific financial transaction taxes exist in Austria, Greece, Luxembourg, Poland, Portugal, Spain, Switzerland, Hong Kong, China, Singapore. The US-state of New York levies a stamp duty on Wall Street (*New York Stock Exchange* and *NASDAQ*) on all firms based there, although at the extremely low rate of 0,003%.

Technical feasibility

Technically the FTT can be levied easily and at very low costs. All transactions at the stock exchanges are captured by electronic platforms. A simple electronic tag would automatically transfer the tax to the relevant tax office. Avoidance is extremely unlikely since circumventing the electronic platforms would be very costly.

Regulation or revenues – false opposites

The FTT would have, just like the Tobin Tax, a regulatory impact. It would reduce speculation and excessive liquidity. This would contribute to greater stability of the financial system. In addition, with an appropriate tax rate, the revenues could be considerable. Both effects are welcome and should not be viewed as contradictory.

Which tax rate and which revenues?

The tax rate should be as high as the British *Stamp Duty,* i.e. 0,5%. In respect of revenues, a tax rate of just 0,1% would yield globally 734,8 billion USD a year in a scenario where there would be a medium reduction of transaction volumes resulting from the tax. At 0,1%, for Europe the figure would be 321,3 bn. USD and for North America, 313,6 bn. USD. In other words, with the revenues generated by the US alone, the above mentioned increase in public debt by 2014 could be paid for by the FTT within eight years. In Europe at an even shorter term.

What to use the revenues for?

As the tax is levied on asset markets, and since these are highly concentrated in half a dozen marketplaces, the bulk of the revenue would accrue in particular countries, such as the US, the UK, Japan, Switzerland, Germany, France and Singapore. They could use this revenue to reduce the public debt incurred in the management of the crisis.

However, these few countries should not be the only ones to benefit from the FTT. The asset markets are international markets and have caused damage to the whole world. Therefore, it is entirely legitimate that a substantial proportion of the revenues – for instance one third - should go to an international fund under the auspices of the UN. A part of that money could be distributed to the countries who had to bail out banks and create stimulus packages to mitigate the effects of the crisis but do not have important asset markets.

Another part should go to the financing of global common goods. In the first place, to combat global warming as well as hunger and poverty in developing countries.

In any case the precise distribution of the revenues should be fixed in a democratic process.

Literature: Stephan Schulmeister, Margit Schratzenstaller, Oliver Picek (2008): A General Financial Transaction Tax Motives, Revenues, Feasibility and Effects. Vienna.

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