The Tobin Tax : earlier debates

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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. A public campaign for a Tobin-like 'Robin Hood Tax' has gathered a good deal of support.

During 2011 the case for an international levy on the banking system was discussed at the G20, though without a consensus being reached. In September 2011 the European Commission published proposals for an EU-wide tax on financial transactions, though, again, the prospects of such a tax being adopted by all Member States is uncertain. 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. It has also argued that its introduction of a new levy on banks' balance sheets in January 2011 meets many of the aims set for a Tobin tax without some of its possible drawbacks. This note looks at the background to the debate on taxing financial transactions, while a second note looks at these recent developments in more detail.[1]

[1] *The Tobin Tax : recent developments*, SN06184, 16 January 2012

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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 not be costless either, the main purpose of the plan will not be lost. At least the bank facilities

[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

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

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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

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

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 …
>
> **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 he applied where the transactions

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

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 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 Lords[11] 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. 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

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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

> 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 …
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> 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.
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> 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.
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> 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 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:

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[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.

> 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." …
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> 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 The aftermath of the 2007 financial crisis

3.1 Criticism of the banking sector in 2009

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. But he recalibrates the debate by asking: what kind of financial sector is most useful to

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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

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 Strauss-Kahn, reportedly said that the Tobin tax was "a very old idea that is not really

[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

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.
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> 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.
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> 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]

[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

3.2 Assessment by HM Treasury

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 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.
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> 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.

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[28] HC Deb 10 December 2009 c25WS

[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

> 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 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.
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> 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.
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> 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

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[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

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 $34 bn.[36])

3.3 The Robin Hood Tax campaign

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 Schmidt[39] 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

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35 HC Deb 10 February 2010 c912

36 Congressional Budget Office, *Report on the Troubled Asset Relief Program*, December 2011

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.

> 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":

> 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

[40] "How it works: the big idea", *Robin Hood Tax*, retrieved 6 April 2010
[41] EDM 913 of 2009-10, 23 February 2010
[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

> 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;
> - 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]

It is notable that, despite its support for some of the aims of the Robin Hood campaign, the Labour Government strongly opposed any unilateral action by the UK. In the 2010 Budget report it simply stated 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] with little indication that the events of the past three years had created a workable consensus for a new global tax.

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[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

[45] HC 451 March 2010 p37

[46] HC 451 March 2010 para 3.10