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The Tobin Tax Revisited*

Abstract

The idea that governments necessarily have a critical role in economy and society is again plain since the global financial crisis. For 30 years, the democracies said they were ineffectual in coordinating economic life, and markets were perfect for this political role. The report provides a corrective to the attendant policies based on these views, by using the Tobin tax, a proposal once again in the news, as an illustration. Through an interpretation of the ideal and less than ideal relations between governments and the financial sector, it assesses the Tobin tax. Criteria about its feasibility and desirability are drawn from this broader framework about the purposes of banks and their role in society. A Tobin tax on global financial transactions is a very modest reform, so modest that the vehement opposition by the financial sector could also be subject to interpretation.

* I would like to thank Mica Panic (Cambridge University) and Sam Whimster (London Metropolitan University) for their comments on earlier drafts of this report. It was completed before the US SEC charges were made against Goldman Sachs & Co (16 April 2010). Subsequent debate could strengthen the case for reform/s.

The Prime Minister, Gordon Brown, proposed a Tobin tax on financial transactions at the meeting of G20 finance ministers on 8 November, 2009. It is one of many, many proposals since the global financial crisis. The tax, long rejected by the US Administration and the financial sector, is now back in the news with European support. Why is the tax such a touchy topic? Are objections well-founded or are there other, more worrying elements of it? What have Tobin tax proponents hoped to achieve? Without doubt, too much is expected of the tax; for example, it would force banks to pay for huge state costs of bank bail-outs and stimulus packages, it would curb 'excesses' in financial trading and perhaps fund global development and energy alternatives. It sounds like magic.

My aim is to take an interpretive view of the state-economy relation to give some public clarity to reform proposals, by using the Tobin tax on financial transactions as an illustration. Technical disputes between economists, the financial industry and populists are part of the problem.¹

There are two types of 'crisis averting' proposals and many rightly accept some mix is necessary. First, the Tobin tax is a *market-type reform* to change incentives in trading. (Many taxes aim to raise revenue, or to discourage socially negative activities, or both: the financial industry is lightly taxed.) Secondly, there are stiffer regulations for improving *the nature and activities of banks and shadow banks*, even to the extent of dealing with systemic problems. Accepting that we cannot

know if political fortitude will emerge from our governments, and noting that thousands of regulations already exist which either fostered the crisis or proved ineffective, I ask whether Tobin-type taxes are *possible* and feasible. I will then consider criteria for *desirable* reforms, and whether a Tobin-type tax meets some or any of these.

A brief background to the Tobin tax is presented first. The idea was proposed in 1972 by the US economist James Tobin who argued for a small tax on 'all spot conversions of one currency into another, proportional to the size of the transaction' (Tobin 1978: 155), as a financial disincentive aiming to induce, *through the market*, slower financial movements. Tobin said it would mitigate the problem of 'excessive inter-currency mobility of private financial capital' (1978: 153).

In many versions of the scheme, a 1.0 to 0.01 per cent tax would be levied on transactions. Tobin wanted it to apply 'to all purchases of financial instruments denominated in another currency – from currency and coin to equity securities', and to 'all payments in one currency for goods, services, and real assets sold by a resident of another currency area'. He had no wish to limit trade, but saw 'no other way to prevent financial transactions disguised as trade' (Tobin 1978: 159). A small tax level is most onerous on volume trading with fast turnover. He wanted these incessant, large transactions to be reduced, in order to 'moderate swings in major exchange rates' and to encourage money to stay put for long-term investment. It would

make fast and heavy flows of 'hot money' suddenly quite expensive.

A large literature now exists on the idea. Global capital movements have multiplied and traditional currency transactions (alone), according to Bank for International Settlements (BIS) estimates in 2007, comprised some US \$3,200 billion in daily turnover in foreign exchange markets.² Of that, Forex trade by 'non-financials' is about 17 per cent, and hedging-speculation accounts for more than 80 per cent (Garnaut 2009: 68-71). Overall, the total turnover of the main spot and derivatives markets rose from 22 times world GDP in 1995, to nearly 70 times in 2007 (Darvas & Weizsacker 2010: 3-4).

Opponents of Tobin argue that transactions provide hedging, give 'depth' to liquidity, and arbitrage helps in 'price discovery', therefore none of these transactions is 'speculative'. Tobin insisted it was simply for technical-Keynesian purposes of throwing 'sand in the wheels' of international finance, to provide a 'modest national autonomy in monetary and macroeconomic policy' (Eichengreen, Tobin & Wyplosz 1995: 163), although it might not reduce risks of a massive crisis or 'excessive volatility'.³ To counter these dangers, later proposals for a second-tier Tobin scheme argued for a prohibitively high penalty tax to apply automatically on panic or contrived panic runs on exchange-rates, i.e. aimed at prevention. This is alleged (Wahl & Wardlow 2001) to benefit regions most at risk from frivolous runs and is another term for capital controls (with the Tobin tax a 'soft' control).⁴ One example in February and March 2010 were

the sudden bets on a Greek default, although Greece is relatively wealthy and has the capacity to improve its public finances.

Soon before he died in 2002, Tobin still supported the tax, but worried that too much was hoped of it; and he did not want it used to oppose global trade (*Der Spiegel* 2001). Tobin's aim is *not* primarily a source of tax-collection, but imposes an incentive through the stick of a tax to discourage socially negative transactions. If

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social benefits result, tax receipts are far less. I discuss this further under the heading of desirability.

With Gordon Brown's latest revival of Tobin, and endorsement by President Sarkozy and Chancellor Merkel, its purposes again extended beyond Tobin's initiative of 1972. At the G20 financial crisis meeting in St Andrews (November 2009), the Prime Minister argued 'there is a real and understandable concern about the fairness of risks and rewards for taxpayers, citizens, shareholders and bank employees ... and it cannot be acceptable that the benefits of

success in this sector are reaped by the few but the costs of its failure are borne by all of us'. He proposed ways that the financial sector 'might contribute to the potential cost of any remaining risks which would be otherwise borne by the taxpayer', with capital insurance, systemic risk levies and resolution funds, and a 'financial transaction tax as a means of increasing the contribution made by the financial sector to broader social objectives' as HM Treasury describes its Tobin brief (for an IMF report due in April 2010, as required from the G20; HM Treasury 2009). The intention here is for the Tobin tax to gain tax revenue, and perhaps legitimacy from an angry public. It side-steps the aim of discouraging negative behaviour. I treat these two aims separately.

The paper is a sociological analysis which disputes the assertions that one can easily distinguish between speculation and hedging, or between the precautionary motive and wild risk-taking. A *motive* to hedge one's 'bets' can transform into *activity* that is like gambling (but passes on risks); and vice versa. The lead-up to the global financial crisis, it needs to be remembered, was motivated (or justified) by the banks as spreading risk.⁵

In looking at opponents, one must note that *no one* fully understands the capital markets, much evidence about reforms is inconclusive and predictions are always guesses. Precautionary measures are all that can be hoped for. The sooner the financial industry stops demanding 'certainty' the better but, like global warming, political and social conflicts are immense. So, my final point is:

Given uncertainty, *no-one can predict the outcomes of reforms, or the sources of another financial crisis.* It follows that it is time to move beyond technocrats closing each loophole after each disaster, which is one reason for contradictory rules of the past 30 years and their unintended consequences for us all. Honest public experiment is in order, with or without a Tobin-type tax.

The main arguments deployed by Timothy Geithner (US Treasury Secretary), Dominique Strauss-Kahn (IMF managing director) *et al* against Brown's idea were presented as technical. So, too, the financial sector's opposition also claimed to be a 'technical' rebuttal of Tobin's 'technical' idea. Political-technical opposition that a tax is not feasible – i.e. not *possible*, is different from opposition purporting to be 'technical' but involving serious discrepancies in economic theories and, ultimately, social theories and systemic relations, on *desirable* reforms. Keynesians (who are Tobin supporters), are in battle with neo-classical economists, as we shall later see. From a sociological view most protagonists offer predictions for *and* against a Tobin tax which are only *conjectures*. Political-technical objections, which I discuss in this section, have been refuted for some time.

Political-Technical Objections: 'neither possible nor feasible'

The first objection is that imposing a Tobin tax is not feasible 'technically' because the tax would be difficult to collect. This is clearly untrue. The

UK's stamp duty on the value of spot share transactions is very cheap to collect (Darvas & Weizsacker 2010: 7). The computer infrastructure at the interbank level is supervised by the BIS. Tobin 'radicals' argued years ago that existing technology can be put to 'democratic ends' with considerable technical ease (Patomaki 2001:146-7; Wahl and Wardlow 2001).

It is disingenuous of banks to oppose a transaction tax on such grounds, because they charge customers for all conversions of currencies. Other aspects of 'technical' opposition are curious, like problems of money-laundering and financial havens for terrorist activities which could be tracked and, even if difficult to identify, *might* be deterred by a progressive tax.

The second argument, by Geithner, is that banks would pass the costs of a transactions tax on to customers (and the rest of society) – and similarly that the UK's 50 per cent (one-off) tax on executive remuneration 'could be easily circumvented' (Parker & Murphy 2010). As noted, banks already take a myriad of lucrative fees from customers. Options discussed in January 2010 by the Obama Administration were a tax based on the size and 'riskiness' of an institution's loans and other financial holdings, or a tax on 'profits'. By March 2010, Gordon Brown looked to some similar levy (Parker, 2010). Although 'Geithner has said repeatedly that taxpayers should be repaid in full for the bail-out' (Calmes 2010), his negative arguments against Tobin and bonus taxes surely apply to *any* proposed taxes. These technical objections

accept that governments are neither willing nor able to set effective controls on, nor to tax, the industry.

The only way for democracies to prevent tax evasion, cost-passing, relocation and banks redefining 'profits' to 'losses', or 'riskiness' to 'risk-free' strategies, is to be firm. It remains to be seen whether they will be firm, but *at the least* government officials could stay aloof from Wall Street/the City. The lobbying spent by the financial industry distorts electoral processes. Revolving doors and poaching among governments and finance could be prohibited via well-designed employment contracts. Any bank which relocates taxable activities could lose transfer rights,⁶ or which passes on costs to customers could be fined. Geithner and the more critical President Obama have yet to develop the political fortitude of President F. D. Roosevelt (though to be fair, this took some time). In his October 1936 speech announcing the Second New Deal, he said:

Powerful influences strive today to restore that kind of ['do-nothing'] government with its doctrine that that Government is best which is most indifferent to mankind. ... We had to struggle with the old enemies of peace – business and financial monopoly, speculation, reckless banking, class antagonism.... They had begun to consider the Government of the United States as a mere appendage to their own affairs. And we know now that Government by organized money is just as dangerous as Government by organized mob. Never before in all our history have these forces been so united against one candidate as they stand today. They are unanimous

in their hate for me – and I welcome their hatred. (Roosevelt 1936)

A third, more political ‘technical’ argument much quoted at the G20 meeting in late 2009 and by Gordon Brown, cites seemingly insuperable political problems about gaining uniform global agreement. This means *any tax* wouldn’t work unless all countries imposed it, on grounds of relocation ‘off-shore’ as above. James Tobin supported a system of international uniformity enforced by the IMF, but always said he thought it had no chance.

I realize that ... I am seriously opposed by a powerful tide... I cannot expect bankers and others who would pay the tax, or suffer any reduction it might cause in the transactions from which they profit, to approve. They, of course, have considerable influence on central bankers and on international monetary and financial officials (Tobin 1996: 498).

Tobin’s comment could help explain why the CEOs of Deutsche Bank and Barclays proposed a *uniform* insurance tax at Davos in January 2010. Maybe its increasing political support (at the time of writing) will prove a breakthrough to greater uniformity but, as will be discussed, does it change behaviour to *prevent* dangers? Insurance can *increase* dangers. In contrast (and not whether it is desirable), a Tobin tax is simple and not easily re-defined, because it applies to the most ordinary and quickest short-term transaction alike.

Although global uniformity is important for better ‘feasibility’, some Tobin proponents take the

problem of gaining a uniform tax to be a technical argument too, saying that, provided it involved Europe, and Japan ideally, it could give a critical mass. Others call for the US imposing it unilaterally (Baker 2000). Their technical argument is that most currency transactions start and end in five or six currencies. In 2007, the UK Forex transactions, for example, were dollar and euro primarily, then yen and pound sterling and, to a far lesser extent, the Swiss franc, Australian dollar and Swedish krona (BoE 2007). Over 97 per cent of EU spot and derivative transactions take place in the UK and Germany (Darvas & Weizsacker 2010: 9). Some suggest a lower tax rate is less liable to evasion in the absence of global uniformity (Patomaki 2001: 164-5). Here a seemingly technical problem is used to avoid admitting political opposition.

With the unparalleled increase in financial products during the 1990s, *and* in inequality, the Tobin tax became a demand of social movements opposed to global poverty. Hope was also placed on carbon taxes before carbon trading became *de rigueur*. James Tobin (1996: 498-9) was heartened that former US Federal Reserve chair Paul Volcker and Stanley Fischer (then IMF Deputy Director) were interested in his tax after Mexico’s distress in 1996. And, immediately after September 11, 2001, considerable government interest grew in favour of equity. Gordon Brown, then Chancellor of the Exchequer, proposed taxes on Forex transactions (Tobin tax) and on arms deals in November 2001. Major work by international bodies (not just protesters) led him to make calls for a

'global new deal': the US blocked it.⁷ Indian and French Prime Ministers supported a Tobin tax; German, Brazilian, Belgian and Malaysian leaders expressed 'interest'.⁸

Major governments might, then, be persuaded to agree on some tax. As we know, the Tobin idea and equity measures that might isolate terrorism were lost from view after 2002, with the Afghanistan and Iraq wars. Yet, after the financial crisis, Gordon Brown extended its aims in 2009: to make the finance sector pay for being bailed out, rather than impose burdens on populations. So, for some, it is a tax that 'collects the money where it is abundant' (Wahl and Wardlow 2001: 13); and to others, it aims to reduce activity 'of no economic value added' (Turner 2010). In fact, many existing taxes involve both aims, even if they are analytically distinct.

In sum, any future tax is *most* effective when global. While feasible, others argue Tobin's uniform idea is too slight: Paul Davidson (1997) wants 'boulders' not mere sand. Orthodoxy's defence of the benign nature of financial markets is re-emerging *even when*, as Volcker said to US bankers (Luce & Braithwaite 2010), there is not a scrap of evidence to show *any benefits* from the financial activities of the past 20 years. Like Tobin, Volcker disagrees with the notion that these markets are efficient and incorporate the latest information. (The ugliest issue still remaining is who gets privileged access to information.)

James Tobin's further aims clarify the feasibility problem. I then assess systemic problems.

What did Tobin really want, in regards to feasibility?

The clearest explanation of Tobin's scheme is in his 1978 article. He is not as stressed about exchange rate flexibility (introduced in 1971) as about the effects of mobility of private capital in fixed *and* flexible regimes. Significantly, he recommends the tax only with deep regret, failing an integrated world with 'a common currency, common monetary and fiscal policy, and economic integration' (1978: 154). This *implies*

‘The global financial crisis showed how the world’s finances have become more integrated than ever before’

a democratically elected global government, with a Treasury. He recounts benefits of federalism, for reducing 'movements of funds to exploit interest arbitrage or to speculate on exchange rate fluctuations', with their social 'disturbances and painful interregional adjustments' (Tobin 1978: 155). Although the European Union is bravely moving towards such federalism, (which Tobin welcomed), it still lacks democratic and fiscal institutions to make regional economies 'tolerable' across Europe. These strains are marked

since the global financial crisis.

Accordingly, Tobin saw that the 'one world' ideal was unlikely to be viable 'soon', which is why he felt, with financial markets having become so international while goods and labour (and their prices) move much more 'sluggishly' (1978: 154), that 'something' should be done to minimise negative social effects. In 2010, the viability of the 'one world' ideal remains a huge 'if'. The global financial crisis showed how the world's finances have become more integrated than ever before, with risks passed onto *billions* of citizens. But the institutions of international cooperation and financial regulation are weak, and driven by neo-classical ideas. It was only a year ago that the G7 was *the* advisory entity: G20 is a major improvement in widening decision making. But governments vary greatly from one another (even in the democracies) and global governance remains a distant prospect. What seems likely is a pluralising world into regional blocs whose dynamics have yet to develop.⁹ Whatever responses do emerge, they are an historical experiment with few precedents.

The next section explores the tax's desirability according to different theories of proponents and opponents. With the crisis, many taken-for-granted ideas were found wanting while politicians faced an urgent need to 'do something'. This places the legitimacy of states in difficulty since, in democracies, agreements have to be sought with the major conflicting social groups. The trend for some time has been for technocrats in the public and private arenas to take control, largely on the

understanding that the economy is the preserve of private economic actors and (excepting a financial crisis) the state as an actor should stay outside the economy. Few economists extend their expertise to wider and more serious theories of the state, money and policy. Keynesians are more modest, albeit also with a technocratic world-view.

There is no doubt that the public favours wider control and a 'populist' (or 'democratic') tax on the sector. For governments, a big tax could also stem a market revolt against government debt (created to bail out the self-same sector). This is politically tricky. Nationalism is usually an element of populism, while the City asserts its post-imperial cosmopolitanism. With regards to the Tobin idea, *even if* the City were induced to fund new service and manufacturing industries in the UK, such productive development would take a while to build. The possibility of a City in decline means UK politicians are anxious, even to the point of dissimulation.

We do not know how these opposing interests will play out in the UK. Conventional commentators, today, tend to agree that short trips of 'hot money' show little inclination to invest in the longer term development of society. Instead, financial institutions lend to each other, boosting the volume of financial transactions in order to make capital gains (and to an extent undreamt of by James Tobin). This resulted in high unemployment and distress, whereas funding for development creates *new wealth*.

What are the social purposes of banking and money?

The issue of wealth creation raises the *most sensitive question* – the social purposes of money and the obligations of banking (raised, and recently qualified, by Adair Turner: 2010). Tobin used a Keynesian view to justify his tax idea. He was also influenced by Joseph Schumpeter. Perhaps banks need reminding that they are the ‘engine of capitalism’ (Schumpeter 1954: 318; 278), and not simply the ‘intermediaries’ between lenders and borrowers of orthodox theory. The purpose of banks is to take the risks of funding new development which creates future wealth. But, under competitive pressures for ‘dis-intermediation’, the dynamism of credit-money was precariously put to trading financial products in the capital (wholesale) markets on high levels of leverage. That resulted only in a ‘small proportion’ of UK credit going to financing investment and trade (Turner 2010: 17). Moreover, the creation and sales of financial products (promises) were done by shadow banks and banks, showing they *were* intermediaries however much a diversion from the original Schumpeterian role.

In regards to money, Schumpeter also shows how ‘loans create deposits’ which are in turn lent out, deposited, lent out, many times over. But these banking practices became lost from public view when banks gained ‘self-regulation’ and disputed the need for effective prudential central bank supervision. As we can now see, banks’ money-creating powers are ‘special’. Unlike the arduous production of goods and

services, money is manufactured in mere acts of lending and borrowing. Yet if credit-money is created ‘without limit’, as it can be, this is ‘dangerous’ (Schumpeter 1934: 114). Just as with fiat money (currency), credit-money is ‘freely produced’, but ‘too much’ can lead to inflation (and worse) in the absence of *limits* imposed by the authorities to make money scarce (Ingham 2008: 75).

A series of historical compromises between the antagonists in money relationships have come to mark modernity, capitalist economies and their relations to governments. Yet, the ‘compromise’ after the 1970s (wrought by Volcker) had few beneficiaries other than the financial sector which gained ‘certainty’. In Anglo-American countries, the legitimacy of the old democracies came to be disputed by private sector interests. Wall Street and the City acted as competing city-states, as though adrift from their institutional boundaries. Between 2001 to 2007, US and UK limits on private bank credit-money production hardly existed, the UK being the worst offender with its ‘light touch’. This unfortunately is a well established historical business model of some 400 years: the damage of private banking fecklessness is passed on to the nations’ populations (via hapless governments) as money contracts after ‘expanding’.¹⁰

Despite problems of defining the line between investment and gambling, the danger of collapse is more likely when increased financial ‘intensity’ does not result in ‘improved capital allocation, increased growth, or increased human welfare’; nor, as Adair Turner also argues, in delivering

‘value added for the real economy’ (2010: 6). Banks might create ‘cheap’ near money and trade at high speeds. But in 2008 central banks had no option but to lend the more reliable and trustworthy fiat money to private sector banks, or else the payment system would have collapsed. The rescue will have its own as yet unknowable effects.

Lending for innovation in profitable developments is ‘self-amortizing: it creates a debt, but also the value-added to repay principal and interest. By contrast, loans to create or buy financial assets and instruments are not’ (Bezemer 2009: 9). A credit boom is a zero-sum game reliant on general economic activity which eventually cannot produce revenue sufficient to pay back rising debts.

In early 2010, systemic problems remain the focus of debate. The fragile banking system of a smaller number of larger oligopolies which can ‘move markets’ (and thus ‘win’) has returned to its old ways, lending and borrowing for bets with privileged information. This is so to such an extent that the BIS asked global bank CEOs and main central bankers to discuss the resurgence of ‘excessive risk taking’, and BIS reports that ‘financial firms are returning to the aggressive behaviour that prevailed during the pre-crisis period’ (Sender 2010).

Meantime, if banks are enjoying ‘a colossal and also lucrative carry trade ... [such as] borrowing at zero in the US and lending at, say, 9 per cent plus in Brazil’ (Lex *FT* Jan 8 2010:12), they lend for development even less. They perceive too many credit risks, and entrepreneurs and consumers

are equally preoccupied in servicing their debts and unwilling to take on new debt to finance production and consumption (Ingham 2008: 70).

Banks need reminding of the social purposes of credit creation. The question, from Schumpeter’s analysis, is how to compel and cajole banks to lend in their dynamic, wealth enhancing role. The producers and controllers of money, after thirty years of unregulated competition became predators on the social fabric. They passed on risks to society, and even now retain the upper hand in terms of economic and financial power, which is ironic at best and insidious at worst since so many government officials and even ministers were themselves in the financial sector. Interestingly, the *Financial Times*, industrialists and other erstwhile supporters of the sector now describe this problem as the lack of public legitimacy in the settlement between governments and the financial sector.

So, given the situation as it is today, is a Tobin tax desirable, or are other measures better?

Opponents

Neo-classical economists are vehemently opposed to a tax on the wholesale money markets because they believe, despite all that has happened, in the ‘efficient market hypothesis’ as does the financial industry. According to a large inter-dealer broker, Tobin taxes:

would drive high-frequency traders out of countries where [the Tobin taxes] are imposed or prompt them

to cut back on their trading. ... they would have a large impact on the costs. ... Any friction in the marketplace in terms of taxes is dangerous. ... It will slow down trading activity and *reduce the commissions and taxes raised in the financial sector*. ... It ... could harm other investors, who will find the equity and bond markets less liquid and face larger spreads. .. [and harm] the *already fragile capital markets* for smaller companies. ... a US-based Tobin tax could drain so much liquidity out of the markets that it would affect the dollar's status as a reserve currency ... Business likes certainty [the Chair of GFI Group concluded]. (Masters 2010, my emphases)

Wholesale markets must not be touched. Banks' purposes of creating money to fund wealth-creating future development (or *whatever*) are merely a function of the spreads, the narrower the more efficient. But if low transaction costs played a role in the explosion of trading activity, that rise also 'significantly outperformed the pace of expansion in economic activity' from 2000-07. Therefore, the allocation of capital and risk to the production process cannot have been as 'efficient' as market defenders claim (Darvas & Weizsacker 2010: 5-6). In other words, more transactional activity was generating less economic activity in the non-financial sector.

Indeed, the wholesale markets created liquidity at hitherto unseen levels up to 2007, and suddenly, sales in some assets stopped, no 'price' could be given, 'market liquidity' was not available (Turner

2010: 11) and some markets ceased to operate. The financial markets suffered the equivalent of a run on the banking system (Access Economics 2009: 27). It was an own goal in the sense that it was created from within a near-frictionless financial machine (*not* from a Tobin tax). Keynes's warning that there is no possibility of liquidity of investment for the whole community, i.e. a farmer cannot switch every asset to money

‘The producers and controllers of money, after thirty years of unregulated competition became predators on the social fabric.’

deals on Monday and return to farming on Friday, is not addressed. Turner wants to 'dethrone' the idea that 'more liquidity, supported by more trading, is axiomatically beneficial' (2010: 1).

Worries

Opposition to a Tobin tax presents a view of society comprising markets alone. Their neglect of banking corporations, and failure to consider the purposes of banking, are

worrying. More, their predictions replicate their faith in predictive models that fed the crisis.

Yet some claims for a Tobin tax *are* dubious. In discussing how banks ‘rigged the market’, a *Financial Times* journalist urged that there be

... scrutiny of the structural distortions that allow these institutions to rack up such huge profits. Broadly speaking, the leading players ... have been operating natural oligopolies. Their profits have been in significant part a reflection of the absence of robust competition. ...[enabling banks to] extract rents out of all proportion to any contribution they make to the wider economy. ... The absence of sufficient competition has been raised by Lord Turner, the chairman of Britain’s Financial Services Authority. He has suggested a transaction tax to deal with the problem in wholesale markets (Stephens 2010).

It seems fanciful to imagine a Tobin tax could introduce competition – and Turner only claims the tax might reduce dangerously excessive market liquidity (Turner 2010: 2). It could diminish the market-moving capacities of large oligopolies and *the pace* of competition, given both of these are newly powerful capacities restricted to very few economic agents.

Also, if a Tobin tax worked, *effectively*, tax revenue for public equity would be short-lived. There might be less instability for domestic economies (perhaps) and banks might lend for long-term investment. If a Tobin tax does *not* change transaction behaviour,

tax receipts might rise but, only for countries where the bulk of wholesale trading takes place (in Europe, the UK and Germany). Tobin cannot be an evenly-distributed source of *global revenue* for public purposes (but lucrative for the UK’s general budget).

Finally, which proposal would change the structure of competition? If oligopolies are ‘bad’, is the problem solved by more entrants? Some assume that competition is an answer for all ills. Wider *choices* rather than an increased number of providers selling roughly similar services could produce more responsible types of banking practices. At present the financial sector is in a spiral of ‘autonomous competition’ whose dynamics are well beyond the understanding or public utterances of Goldman Sach’s Lloyd Blankfein or Deutsche Bank’s Josef Ackermann. There is an impasse in a dysfunctional system which resists all change, with little hope for a settlement that could claim legitimacy in the minds of the majority of citizens, leaving aside the inability of politicians to broker and legitimate such a settlement.

Other taxes and regulatory measures

In Europe since 2008, regulators have been experimenting on changing the prudential requirements for banks, and altering banking behaviour over time periods and cycles. Dynamic provisioning by banks and variable capital surcharges can ‘lean against the wind’ of asset inflations and busts (Posen 2009: 10). This is an improve-

ment on predictive risk analyses, because all proposals are conjectures. Adam Posen (2009: 13) suggests a Tobin-like tax on real estate transactions, similarly not for tax revenue aims but to change incentives *variably* against real estate booms and busts.

Although major revenue-collecting taxes are the key democratic demand (which Tobin or real estate taxes cannot meet), many of these taxes disappeared after the 1970s. Governments introduced global financial regulations that aimed to 'harmonise' financial interests. Some investment rules against what is termed 'expropriation' explicitly counteract national attempts to improve living conditions (Schneiderman 2001: 531; Schaberg, 1998). The privatised nature of economic globalisation is behind the reduction of progressive national taxes on corporations, and the failure to work out global corporate taxes. Private equity firms enjoy extraordinarily lucrative tax rates (15 % on capital gains: *Lex FT* 2010, Feb 4: 12).

An insurance levy is worse than other taxes, because it fosters moral hazard of another rescue rather than containing 'excessive' fragility of credit expansion. Worse, insurance can foster carelessness within the insurance contract itself. Insurance does not *prevent* dangers which affect many populations, but reinforces a sense of entitlement by banks. An insurance levy might save government costs of monetising banking disasters, but that will not rescue the world at large.

The financial sector is notoriously hard to tax: profits are shifted offshore in the conspicuous absence of

international agreements. Fischer Black, who invented the option pricing framework, argued in 1972 that it was a form of leveraged gambling which should be taxed (like gambling), and he refused to be involved personally or, in 1994, with Long Term Capital Management (LTCM). He was appalled that LTCM was 'loading up on risk' – heavy short-term debts which can bring down a firm (cited Mehrling 2005: 138-9; 297-9) as well as others. Some now suggest taxes on short-term loans to prevent constant crises, rather than for revenue purposes.

Also, it should be pointed out, that unlike other economic sectors like manufacturing, the finance sector is 'essentially' exempt from value added taxation. The amusing side of this is the difficulties in measuring the 'value added' in financial products (Darvas & Weizsacker 2010: 8). The realist side, signified in the phrase 'financial services *industry*' is there is a perception by the *industry* that, like others, they are creating and selling value-added service products. This gives rise to two thoughts: If financial products do not create value, do they allocate capital efficiently and so perform 'benefits for the real economy' (Turner 2010: 1) that taxes (whether VAT or Tobin) would 'distort'? And, secondly, if they do create value services, why are they not taxed at comparable rates to others? This takes the discussion some distance away from the Tobin tax itself as well as the levels at which states normally tax economic processes, and perhaps leads to another, deeper analysis of what constitutes value.

What could Tobin taxes achieve?

Public-finance perspectives suggest there is only a case for a Tobin-type tax if financial transactions cause negative external effects on society. But the tax rate would need to be small (0.01%) so that it did not drive out transactions with 'welfare gains' (e.g. 'efficient' allocation to production: Darvas & Weizsacker 2010: 8; 13). Instead of baying assertions of 'right or wrong', therefore, one could agree that not all derivatives and naked credit default swaps are 'gambling chips'. A corporate pension fund needs a naked CDS against bankruptcy of its *own* corporate sponsor; Rolls Royce needs to hedge dollar-pound changes (Jackson 2010). The question is, which transactions are *running a book* on socially undesirable transactions and contribute to systemic risk? Public finance shows welfare losses as a negative externality of 'diminishing social demand' for a product with market magnitudes where large supply of a product only equals 'private demand' – not the much lower, socially-optimal quantity where supply equals 'social demand'. A very small tax drives out significantly 'bad' transactions but not the others (Darvas & Weizsacker 2010: 13-14). Thus Lord Turner cites how a 'non-trivial proportion of complex securitisation was driven by tax and capital arbitrage', of 'no economic value at the collective social level', which he calls 'socially useless' (2010: 22).

Despite inordinate fear of 'touching' the market, it is possible that Tobin taxes would reduce *private demand* for socially damaging

products, slow its pace and scale, and reconfigure the way decisions are made in the financial sector. Instead of the assertion that high-speed trading leads to price discovery and real 'information', traders exploit minor information advantages, and rely on conjecture, gut feelings, competitive anxieties, from firm and financial centre pressures to win market share (Pixley 2004; 2009; 2010). The exploitation of discrepancies in global prices and of regulatory loopholes, pass on dangers. Taxes on financial and real estate transactions (and variable reserve requirements) do not 'stop' the financial markets; instead, in slowing / diminishing the frantic competition and asset inflations, the necessary trust and confidence is made obvious. Regulators can also think about which loophole to plug next. The faster the pace, the greater the need for trust, which more easily turns into distrust, fear, and dissembling to pension funds and regulators – and to extremes in the Lehman case (Whimster 2009: 269-73). A slow-down might allow trust to counter-parties to be *reconfigured*. It gives something like 'cooling off periods' to re-consult gut feelings.¹¹ Instead of trying to reduce uncertainty, which is not possible, it seems preferable to consider precautionary principles, and taxes which punish undesirable transactions and foster funding for development are therefore socially desirable.

If the aim, however, is to make the financial sector pay taxes *per se*, and pay back its massive debt, other taxes are needed, because the Tobin cannot accomplish that. The

sector should also fund the cost of its effective supervision. (An effective stick of taxes to deter the lucrative carrots of incentives like bonuses and share options could, like the Tobin, be less revenue-creating than a wealth tax). Perhaps governments could call its bluff in this way. If the financial sector wants to avoid taxes, it must prove that it does not 'add value' with the inference that it is socially useless. A Tobin tax that does not drive out the *legitimate social purposes* of banks might well be thought preferable to a value added tax.

Both corporate and government legitimacy with the public is low, although long-term benefits await governments that acknowledge the socially-expressed wishes for a fairer, democratic settlement. A Tobin tax should be removed from the 'index of forbidden thoughts' (Turner 2010: 30) and allow a more public, open discussion of what actually adds value and why it should or should not be taxed. The Tobin tax can only complement other measures, making as James Tobin remarked, a *modest* contribution.

Endnotes

- 1 Sociology no longer aims for predictions or 'laying down laws', but interpretation. Many economic debates for and against financial reforms are couched in dogmatic terms of firm predictions, which is unhelpful.
- 2 According to the BIS 'Triennial central bank survey or foreign exchange and derivatives, 2007 (Bis.org), in 1998 Forex daily turnover was US\$1,490 billion. The BIS is only reporting its next survey in August 2010. On estimations of tax revenue, see Barber T. & G. Packer 2009 'European leaders push case for Tobin tax', *FT* December 12-13: 4. It cites France's foreign minister, Bernard Kouchner, as estimating €20 billion to €30 billion a year could be raised by a levy of only 0.005 per cent. The IMF report of April 2010 will give more precise estimates than is available from the BIS at present.
- 3 I argue that Tobin's 'sand in wheels' metaphor does not acknowledge the social relations of trust and the hierarchical structure of the finance sector. Incentives assume self-interest is the sole driver of human affairs, taken to extremes in the financial industry: positive ones include exorbitant bonuses, whereas negative (tax) incentives that discourage private vices and externalities are a start in this industry.
- 4 Various countries (Chile with a 30% tax), prevent so-called 'hot money' from parking and moving out in a week. India, China have various controls.
- 5 See Pixley (2010) on confusions in behavioural finance between risk (known chances, i.e. gambling proper) and uncertainty (the social world of money and finance).
- 6 In the UK stamp duty (0.5% tax on the value of spot share transactions since 2001), transfer of ownership is only officially stamped after the tax is paid. This is a design issue cf. Sweden's financial transaction tax was easily avoided by relocation. A similar tax is imposed in Ireland, Korea, Australia, Switzerland, Greece, Hong Kong, India and China. The UK revenue started at £2.9 billion pa., rose to £4.2 in 2007 and was £3.2 bn. in 2008 (Darvas & Weizsacker 2010: 6-7).
- 7 This is the phrase used by Gordon Brown quoted from an article in *The Guardian* listed in globalpolicy.org/socecon/glotax/currtax/index, accessed December 5 2001; Denny, C. 2002 'US blocks push to lift aid to poor countries' *Sydney Morning Herald* 24 January: 7
- 8 The French Assembly voted in favour in November 2001, with the 'Association pour une Taxation des Transactions financieres pour l'Aide aux Citoyens' claiming credit for the Currency Transaction Tax (CTT). The Halifax movement claimed victory in the Canadian parliament in 1999. The Jubilee movement on Third World debt relief also supported a CTT. At the UN, John Langmore (personal email), then Director of the UN Division for Social Policy and Development, argued the CTT gained impetus with the UN's Zedillo report on financing for development. Ford & Desir 2001.
- 9 A multi-polar world is a central theme of the Global Policy Institute at London Metropolitan University.
- 10 The reason for historic social compromises in *democracies* is due to the important purposes of money, its dynamism in capitalist economies, and the need for state legitimacy in conflicts between debtors, creditors, taxpayers and government bond-holders (Ingham 2008; and see literature on 'different' forms of capitalism). Politicians turn to populism in face of angry debtors/taxpayers and, in the USA, seem to deny they are politicians.
- 11 The analogy is to house buying on the spur of the moment, where a week's cooling period is mandatory before exchange of contract in some countries.

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