Briefing Paper Financial Transaction Tax (FTT)

The momentum for international Financial Transaction Taxes (FTTs) is growing. Within the G20, driven by strong public campaigning, there has recently been significant debate and promotion of the proposal to apply a tiny tax (average 0.05%) on wholesale financial transactions. That is, trading of currencies, stocks, bonds, derivatives and interest rate securities. A FTT targets each wholesale financial transaction, not commercial transactions such as buying of goods and services, ATM fees, repayment of loans, social security or payroll transactions that most Australians experience in their daily lives.

The implementation of such international FTTs would raise vast amounts of funds, billions of dollars annually, to lessen the worst impacts of the economic crisis, fight climate change and combat poverty worldwide. The aim is to generate funds to redistribute to where they are urgently needed: for domestic social and environmental measures (50%), international climate finance (25%) and overseas aid and development (25%).

The Australian campaign coalition[1] for financial transaction taxes is part of an international movement and argues the case for a global tax regime on speculative financial trades in this Briefing Paper.

Financial Transaction Taxes is not an Undue 'Penalty' for Australia's Banks

There is confusion between a banking profits tax, which is technically known as a Financial Activities Tax (FAT), and a FTT. A FAT is a tax on *institutions* which is levied on bank profits and bankers' remuneration packages, and given the size of bail-outs to commercial and investment banks in Europe and the US, it is understandable that a FAT has enjoyed some political favour. A FTT is a tax on *transactions* that are designated taxable. If an institution never carries out the taxable transaction, then it will never be taxed on that transaction. Or if it carries out only one such transaction, then it will only be taxed for that one transaction. Therefore commercial banks in Australia would only be as affected by a FTT as any other speculative investor.

Financial Transaction Taxes can Increase Market Stability by Reducing Incentives for High Frequency Speculation

Incredible growth of financial market trading in recent years had led to the situation where the volume of financial transactions is now many times higher than nominal world GDP. While in 1990 financial transactions were 15 times higher than GDP, they are now 73 times higher[2]. The volume of foreign exchange transactions is around 70 times higher than world trade – almost entirely due to the enormous boom in the derivatives market. It is generally accepted that the size of the derivatives market today allows speculative trading to far outweigh its use for hedging and insurance purposes.

Additionally, the speed of financial transactions has increased which has led to a tendency for commodities, exchange rates and stocks to fluctuate without converging towards underlying trends. Instead of improving the efficiency of markets in the 'price discovery process' the increased speed of trading exacerbates trends of asset prices and increases price volatility[3]. This excessive liquidity

1 See Australian Robin Hood Tax Coalition website www.robinhoodtax.org.au

2 Schulmeister, S. (2009) A General Financial Transactions Tax: A Short Cut to the Pros, the Cons and a Proposal. WIFO Working Papers, no. 344.

3 Schulmeister, S. (2009) *A General Financial Transactions Tax: A Short Cut to the Pros, the Cons and a Proposal*. WIFO Working Papers, no. 344.

(trading activity) in the market increases volatility, as evidenced in the increased boom and bust cycle we have experienced in the Global Financial Crisis (GFC). Short-term transactions encourage price runs and 'noise trading', both of which also contribute to instability in the global economy. These would be reduced by a FTT as the tax would be an economic disincentive to rapid trading. Price runs would become less pronounced and the boom and bust cycle that we have seen in recent years should become less pronounced.

While Australia's economy and banking sector were largely protected by the direct impacts of the GFC, on presentation of the 2011-2012 budget, Treasurer Swan stated that national revenue "[l]osses built up during the global crisis are larger and lingering longer" as a result of a subdued global economy[4]. Tax receipts are expected to be $15 billion lower than at the 2008-2009 budget, a $45 billion downward revision in 2011-2012[5]. This clearly indicates that whilst impacts of the GFC have been far worse in other countries, Australia is not immune to the volatility of global markets and would benefit from increased market stability.

It is argued that the Australian economy was protected by some of the worst impacts of the GFC due to the comparatively higher regulation of banking sector than in other countries. And this would only further be reinforced by a FTT that specifically targets short-term speculative trade – the kind of transactions that were at the very core of the GFC.

Financial Transaction Taxes are administratively practicable

Over the last few decades more than 40 countries, including Australia, have implemented some form of FTT either on a permanent or temporary basis[6]. The UK stock exchange, one of the world's largest, has a small tax on share transactions. The rate of this tax, 0.5%, is ten times higher than the average proposed tax rate for FTTs, and yet the UK stock exchange remains one of the largest in the world – investors have not been deterred. Argentina, Brazil, China, India, Indonesia, South Africa and South Korea also tax sale of company shares[7]. Whilst Sweden's attempt to impose a FTT in the 1980s was not successful due to poor design, lessons learnt from the successful UK imposition of stamp duty on stocks demonstrate that an appropriately designed system will avoid investor flight[8].

All international transactions are operationalised by central foreign exchange settlement systems such as SWIFT, and therefore are traceable and ultimately taxable[9]. Compared to other tax regimes, a FTT can be efficiently collected at the point of trade as has been demonstrated in Japan and the UK[10]. Furthermore a study from the North-South Institute has found that a Currency Transaction Tax (CTT) of 0.005% would not be disruptive to exchange rate volatility (see Schmidt 2007).

The International Monetary Fund concurs FTTs are administratively practicable[11]. FTTs are difficult to avoid or evade, given the tax can be captured at the point where deals are settled via centralised settlement systems. The tax would be collected by the government responsible for operating a trading

---

4 Transcript of Treasurer Swan's budget speech is at www.budget.gov.au/2011-12/content/speech/html/speech.htm

5 From 2011-2012 Budget Statement 5: Revenue www.budget.australia.gov.au/2011-12/content/download/bp1_bst5.pdf

6 Australia eliminated its federal stamp duty on shares in 2001 as part of the taxation reform accompanying the introduction of the GST.

7 Matheson, T. (2011) *Taxing Financial Transactions: Issues and Evidence.* IMF Working Paper. International Monetary Fund. WP/11/54

8 Darvas and von Weizsäcker (2010) *Financial Transaction Tax: Small is Beautiful.* Bruegel Policy Contribution Issue 2010/02.

9 Schmidt, R. (2007) *The Currency Transaction Tax: Rate and Revenue Estimates.* North-South Centre, Ontario, Canada.

10 Baker, D. (2010) *The Benefits of Financial Transactions Taxes: Statement to the Bundestag.* Centre for Economic and Policy Research.

11 International Monetary Fund (2010) A Fair and Substantial Contribution by the Finance Sector: Final Report for the G-20. www.imf.org/external/np/g20/pdf/062710b.pdf

zone. For example, taxes collected on the Australian Stock Exchange would be collected by the Australian Government, and would be an additional source of revenue for the government, to ensure domestic as well as global benefit.

Financial Transactions Taxes have the Potential to Raise Significant Revenue

The exact amount levied from a FTT depends on the size of tax and exclusions. However, a number of estimates exist: The UN Secretary-General's Advisory Group on Finance (the AGF) reports that between US$2 and 27 billion could be raised by a FTT annually by 2020[12]. The Austrian Institute for Economic Research estimates that a mid-range tax rate of 0.05% on financial transactions would raise annual revenues of $US650 billion[13]. Schmidt (2007) estimates that a 0.005% Currency Transaction Tax on the four major currencies (US$, Yen, Euro and Pound Sterling) would raise over US$33 billion per annum. Another US study has estimated that between US$117 and $353 billion could be raised annually through differentiated tax rates for different markets[14]. The IMF (2010) has stated estimates of $200 billion could be raised annually by a 0.01% FTT.

Imposition of a FTT is likely to dissuade some transactions and, therefore, an accurate prediction of the potential yield is not possible. However, if a 0.05% FTT were collected on Australian "over-the-counter" and exchange traded market transactions between 2005-06 and 2008-09, it would have raised $48 billion (calculations Professor Ross Buckley, University of NSW, Jan 27 2011).

Financial Transaction Taxes have Political and Economic Support

The FTT has strong support in key European Union Constituencies. French President Nicolas Sarkozy and German Chancellor Angela Merkel and her Finance Minister are championing the proposal at the G20 and within Europe. The French and German governments won agreement at the Eurozone Heads of State meeting in March 2011 to proceed with implementing a collaborative FTT. Also in March, the European Union Assembly was reported to have delivered a landslide vote in favour of the EU Commission passing legislation for a Financial Transaction Tax. In May 2011, Finnish Finance Minister and Deputy Prime Minister Jyrki Katainen declared Finland's support for a European FTT.

Former British Prime Minister Gordon Brown has also announced his support, and the UK Government has recently agreed to support a FTT if internationally implemented. Two US members of congress have tabled bills to introduce FTTs in the US in 2010, and House Speaker Nancy Pelosi has publicly endorsed the tax.

In April 2011, a thousand economists from 53 countries wrote to G20 Finance Ministers who are meeting in Washington to urge the adoption of a FTT. Economists wrote: "The financial crisis has shown us the dangers of unregulated finance, and the link between the financial sector and society has been broken. It is time to fix this link and for the financial sector to give something back to society."

For further information see www.robinhoodtax.org.au or contact Stephanie Long, Robin Hood Tax campaign coordinator by email stephanie@jubileeaustralia.org.au and phone (02) 8259 0816.

[12] Report of the Secretary-General's High-level Advisory Group on Climate Change Financing (2010)

[13] Briefing note on Halifax Initiative website http://halifaxinitiative.org/content/policy-brief-ftt-idea-whose-time-has-come-april-2010

[14] Barker, D. Pollin, R. McArthur, T. and Sherman, M. (2009) *Issue Brief: The Potential Revenue from Financial Transactions Taxes*. Centre for Economic and Policy Research and Political Economy Research, University of Massachusetts, Amherst.