The Tobin tax

Bruno Jetin

To quote this article: B. Jetin (2012). « The Tobin Tax ». In M. Juergensmeyer, H.K. Anheier editors, Encyclopedia of Global Studies, Sage.

The Tobin tax

Bruno Jetin.

1. The origin of the Tobin tax.

The idea of a tax on financial or currencies transactions has resurfaced and disappeared many times according to the economic crises and the political tensions they brought.

In 1971, the Nobel laureate economist James Tobin (1918-2002) feared that the demise of the Breton Woods agreements would bring financial instability back to the fore because exchange rates would be exposed to the whim of speculation. He proposed to tax currency transactions in order to curb speculative attacks on currencies and improve the autonomy of the monetary policy (Tobin, James 1978). He considered the revenues as a by-product only and not the primary objective. James Tobin explained that at the time his proposal sank like a stone in a deep well (Tobin, James 1996). But it was revived each time a financial crisis hit a country or a group of countries like Mexico in 1994-95, East Asian countries in 1997-98 and most of the planet with the “subprime” crisis in 2007-08. In between, James Tobin’s initial proposal was refined and adapted to globalised markets thanks to the debate between economists supporting or criticizing the “Tobin tax”.

A first major innovation is Paul Bernd Spahn’s idea of a two-tier currency tax: a low tax when foreign exchange markets are stable and a surcharge when speculative attacks threaten to destabilize currency markets (Spahn, Paul Bernd 1995;2002). Whenever the daily exchange rate goes outside a pre-defined band of fluctuations, the surcharge is applied. Transactions resume when traders accept to trade at an exchange rate inside the band. A second major innovation is the idea that the Tobin tax could be established at the regional or even the national level, and not necessarily at the world level as it was previously believed. This innovation is justified by the way the tax would be collected. Among the various possibilities explored, the tax collection at the settlement of payments appears as the most secure (Schmidt, Rodney 2001). In each country, the settlement of payments is managed by the central bank and is now totally electronically registered: the buyer and the seller, the intermediaries, their geographical location, the currencies involved, the exchange rate can be identified and the tax can be collected automatically by the central bank (Jetin, Bruno and Denys Lieven 2005). All the necessary information is already there thanks to technical progress.

2 The active role of NGO, trade unions and political parties

The alter-globalist movement has much popularized James Tobin’s proposal at each world or regional social forum but also with national campaigns to mobilize public opinions. It was successful in building vast coalitions bringing together radical NGOs contesting neo-liberal politics, development aid NGOs, environmental NGO, churches, trade unions, member of parliaments of various political parties. In Europe, the Association for the Taxation of Financial transactions for the Aid of Citizens (ATTAC) played a special role. It was founded in Paris in 1998 after the French monthly newspaper “Le Monde Diplomatique” published an editorial calling for the creation of the Tobin tax to curb speculation which had devastated East Asia, Latin America and Russia. The revenues would be used to finance development and environmental policies in the poorest countries. Various ATTAC were founded in 40 countries, most of them in Europe. Together with other NGOs, they were successful in getting a law in favor of the Tobin Tax adopted by the French Parliament in 2001 and by the Belgium Parliament in 2004. These laws said that the Tobin tax would be implemented in these countries when all other EU member countries would do the same. So, a lot of pressure was exercised on the European Parliament and Commission in favor of the Tobin tax. One of the strength of the NGOs network was its capacity to use the work done by academics in favor of the Tobin tax to respond to criticisms of its opponents in these various institutions. But despite these many efforts, lobbying and public demonstrations they were not able to make a major breakthrough due to the refusal of European government and the fierce opposition of the finance industry. A change of attitude appeared in 2004 when France, Brazil, Chile and Spain decided to establish a technical group on innovative financing mechanisms under the auspices of the United Nations Secretary General. They were joined in 2006 by 44 countries (now 55) to form the “leading group on Innovative Financing for development”. These countries are looking for new ways to finance the Millennium Development Goals (MDG). Some of them have introduced an “air-ticket solidarity levy” in 2006 to finance UNITAID a central purchasing facility whose purpose is to counter the major pandemic diseases. 3 billion additional dollars were collected in four years. On the 21st September 2010, during the United Nations MDG Summit, Japan, Belgium and France, supported by Norway, Spain and Brazil, have presented a declaration to place a very small levy (0.0005 percent) on financial transactions for development. Apparently, it seems that the NGOs supporting the Tobin tax are eventually closed to victory. A closer look reveals that things are in fact more complicated. It is a levy and not a tax which means that one of the primary goals –curbing speculation- is abandoned. It may be reactivated with the new financial crisis that began in 2008.

3. The aftermath of the 2008 crisis.

The international crisis of 2008 gave a new and strong impetus to the Tobin tax. Once again, banks, speculators and financial markets were involved in the outbreak of an international crisis. This time, the core of global capitalism, the USA, Europe and Japan were struck by the worst crisis since the 1930s. Banks engineered the “subprime mortgage” trap and were rescued from bankruptcy with taxpayers’ money. This disgusted a lot of people for everything linked to finance. The Tobin tax is not the solution to many of the problems inherited from the crisis. But it could contribute to resolve the fiscal crisis if extended to all financial transactions and not only currencies. The rescue of banks cost billions of US dollars and was transformed in public deficits. States have already reacted by deep cuts in public social spending and open or covert tax increases on households. Brutal as they may be, these cuts and taxes will not restore public finance for the simple reason that they will dampen an already fragile recovery. Not only do States need new revenues to revive their economy, they must also respect their international obligations. Among them, the Millennium Development Goals and climate change mitigation stand prominent. On the whole, this will cost hundreds of billions of dollars per year. Only a financial transaction tax has the potential to raise enough revenues to fill the fiscal gap. . Global revenues estimates, when all financial transactions including derivatives are taxed, range from $ 288 billion (at a tax rate of 0.01 percent), $ 665 billion (at a tax rate of 0.05 percent) to $ 942 billion, (at a tax rate of 0.1 percent)[1]. Due to the political tension, prominent

[1] Author’s calculations based on estimates of Schulmeister, Stephan. 2009. "A General Financial Transaction Tax: A Short Cut of the Pros, the Cons and a Proposal." *WIFO Working Papers*: 20. WIFO: Vienna.

governments like France, Germany, Austria and Belgium, among other, now officially support the adoption of a financial transaction tax and not only a currency transaction tax. These governments have pushed at the G20 summit in Pittsburg in September 2009 in favor of the Financial Transaction Tax (FTT) and the G20 has officially asked the IMF to study various options -among them the FTT- for a fair contribution of the financial sector to the cost of the rescue plan of banks. The IMF has published its report in June 2010 which recognizes that the FTT is technically feasible but would have negative effects such as an increase in capital cost, a distortion of the price discovery process, an increase of the volatility. It recommends instead the adoption of a Financial Activity Tax (FAT) on profit and remuneration in the financial sector. Supporters have responded to these criticisms but nonetheless, the G20 summit in Toronto in June 2010 has refused the FTT and not endorsed the FAT. The four European governments have also asked the European Commission to study the opportunity and the feasibility of the implementation of this tax in the European Union. The EU Commission has officially released on the 7th of October 2010 an official communication which recommends a Financial Transaction Tax (FTT) at global level whereas at European level preference should be given to a Financial Activities Tax (FAT) favored by the IMF. It is an historical step in the sense that the European Commission responds to the pressure and abandons its traditional opposition to the FTT. But it is a small step because Brussels knows that the standstill at the G20 will not change soon. Civil society will therefore have to continue to campaign for the FTT and try to make a breakthrough at the European level. A new deterioration of the crisis will maybe give a new impetus to their claim.

References

European, Commission. 2010. "Innovative Financing at a global level." European Commission: Brussels.

IMF. 2010. "A fair and substantial contribution by the financial sector." *Meeting of G-20 Ministers*: 57. International Monetary Fund: Washington D.C.

Jetin, Bruno. 2003. "How can a Currency Transaction Tax Stabilize Foreign Exchange Markets?," in *Debating the Tobin Tax*. Washington DC.: New Rules for Global Finance.

Jetin, Bruno and Denys Lieven. 2005. "Ready for Implementation. Technical and Legal Aspects of a Currency Transaction Tax and Its Implementation in the EU." 238. World Economy, Ecology and Development (WEED): Berlin.

Schmidt, Rodney. 2001. "Efficient capital controls." *Journal of Economic Studies*, 28:3.

Schulmeister, Stephan. 2009. "A General Financial Transaction Tax: A Short Cut of the Pros, the Cons and a Proposal." *WIFO Working Papers*: 20. WIFO: Vienna.

SEC and CFTC. 2010. "Preliminary Findings Regarding the Market Events of May 6, 2010. Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues." 151. U.S. Commodity Futures Trading Commission, U.S. Securities & Exchange Commission.

Spahn, Paul Bernd. 1995. "International Transaction Flows and Transaction Taxes: Survey and Options." IMF: Washington DC.

Spahn, Paul Bernd. 2002. "On the feasibility of a tax on foreign exchange transactions." Federal Ministry for Economic Cooperation and Development: Bonn.

Spicer, Jonathan and Kwan Jennifer. 2009. "High-frequency trading surges across the globe." Reuters.

Tobin, James. 1978. "A proposal for international monetary reform." *Eastern Economic Journal*, 4, pp. 3-4.

Tobin, James. 1996. "Prologue," in *The Tobin Tax. Coping with Financial Instability*. Mahboub Ul Haq, Grunberg Isabelle and Kaul Inge eds. New Yord & Oxford: Oxford University Press.

World, Bank. 2010. "World Development Report 2010: Development and Climate Change." *World Development Report*: 439. The World Bank: Washington DC.