

The impact of a Financial Transaction Tax (FTT) on economic recovery and financial stability

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The Financial Transaction Tax (FTT): From Keynes to the current COVID-19 crisis

The decline of the 'glorious 30 years' of Keynesian policies in the post-Second World War period, the fall of the Bretton Woods system and the currency crises in Russia and Asian countries have led to a debate surrounding the possibility of taxing transactions on the foreign exchange market. The most influential voice to suggest such a tax was James Tobin, a US economist of the Keynesian school and winner of the 1981 *Bank of Sweden Prize in Economic Sciences in memory of Alfred Nobel*, who advocated a Currency Transactions Tax (CTT). Tobin's main intention was to use the tax not as a source of revenue, but as a tool to reduce volatility on the foreign exchange markets and to limit purely speculative trading which entailed destabilising risks for the markets and the countries' own economies, as was happening in various parts of the world at that time. The economist never wanted to nullify those markets but rather to curb an over-oiled machine that was endangering the world economy or to make it less efficient, or, as he himself said, to "throw some sand in the wheels of our excessively efficient international money markets".

This idea was nothing new. After another big crisis, the stock market crash of 1929 and the Great Depression in the United States, one of the most influential economists of the

20th century, John Maynard Keynes, proposed a tax on transactions on stock markets. Keynes observed that the fluctuations on the New York Stock Exchange had been greater than those in London. He argued that the difference was due to the absence of a tax on purchases and sales of shares in the United States, which were taxed in the United Kingdom. This difference, according to the economist, made it much easier to join the US stock market than its UK counterpart, leading to stock markets full of inexperienced investors guided by optimism, speculative movements or upward trends, and which made many people rich and looked like they would never stop rising. That was until the bubble burst and panic dragged the stock markets into the greatest of crises. According to Keynes, a tax on transactions would reduce excessive market liquidity and volatility to a more prudent level by directly attacking purely speculative short-term investments, thereby achieving a stabilising and long term positive impact on the economy.

As in the times of Keynes after the great crash of the 1930s and after the crises of the 1970s witnessed by Tobin, whenever we face another economic crisis, we have to deal with the challenge of financing our way out of it – a challenge that forces us to look for new ways of financing and to think about new taxes that, like the economy, are changing, mutating and evolving. This happened after the crisis in 2008, and it is doing so again now.

After the financial crisis that began with the bankruptcy of Lehman Brothers in September 2008 and spread throughout the global financial system because of derivative products, the majority of citizens and governments of many states felt that the financial system did not provide a level of funding commensurate with the enormous damage caused to the global economy by a crisis for which it was directly responsible. The neoliberal mantra of 'deregulation of the markets and the financial system' was laid bare, which discredited it in the eyes of the global population, who saw how the lack of control over the financial services industry turned a crisis involving high-risk, or subprime, mortgages into a contagion affecting the rest of the world economy. Countries' response to the crisis was to rescue the financial system by socialising its losses, while cutting social budgets and raising taxes that fall on the majority of the population to cover the hole in the public deficit that had been caused by saving financial service providers and the resulting credit crisis. Over the last two decades, 20 of the 28 European Union Member States (including the United Kingdom) have raised value-added tax (VAT). In the same period, 27 of them have lowered profit tax on companies. On top of this, the consumption of financial products does not incur VAT, whereas any other consumer product or service does. Why should a family have to suffer as taxes to buy a litre of milk rise to pay for a crisis and a financial system bail-out, while an investment fund can buy millions of euros in financial instruments without contributing anything to public funds?

Against this backdrop, the notion of a Financial Transaction Tax (FTT) regained strength and the ideas of Tobin and Keynes were again

bounced around in Group of 20 (G20) meetings, national parliaments and the main European Union institutions – and in the streets. The reopening of this debate was watched carefully by social organisations and trade unions, led by ATTAC^[2], which owes its name to the relevant tax (*Association pour la Taxation des Transactions financières pour l'Aide aux Citoyens* (Association for the Taxation of Financial Transactions and Aid to Citizens) and which was set up in 1998 after the financial crisis in Asian countries with the intention of introducing the Tobin tax. The demand that financial transactions be taxed to discourage financial speculation took off again, although this time it gained traction in institutional political discourse as a source of funding rather than as a tool of global and anti-speculative financial stability.

In parallel with the failed G20 negotiations and negative reports from the International Monetary Fund (IMF), the European Union (EU) decided to take the lead and discuss the imposition of an FTT at European level. At the request of the European Parliament (EP), the European Commission (EC) drafted a proposal that was presented in 2011. As we will see in the rest of this report, the combined pressure of the financial lobby, some states that depend structurally on the financial markets, systematic attacks by the mainstream media, public authorities like the central banks and a large number of supposedly independent reports led to a reduction in the scope of this tax. The current debate and the latest proposal, i.e. the French/German proposal currently being considered by 10 EU Member States, differ very substantially from the 2011 proposal. The political will of leaders, the public and democratic institutions has once again bowed to the financial power of big capital, resulting in a tax that is more of a political construct designed to please the population than a genuine effective tool to combat financial speculation and also serves as a means of collecting taxes and making banks contribute their share. The new crisis caused by the COVID-19 pandemic presents us with a new opportunity to do things differently and tame the financial sector instead of prostrating ourselves before it.

The kind of economic crisis we are going to have to face after COVID-19 is unlike anything we have experienced before, at least not in peacetime. The economic shock on both the supply side (with business production almost completely paralysed worldwide) and the demand side (with 70% of the world's population being locked down for months with virtually no chance to consume), in addition to a weak economy due to the artificial suppression of the previous crisis through austerity measures and levels of public and private debt that were unprecedented in their nature, have impacted the economies and GDPs of countries – indeed assuming proportions that have exceeded, within just a few months, the effects of the 2008 crisis. In this context, new life must be breathed into the debates surrounding FTT.

The EU, whose members include some of the economies in the global North that are most severely affected by the pandemic, faces the difficult task of reviving an already weakened and over-indebted economy and needs new sources of funding. As a result, new taxes are coming to the fore, such as taxes on the digital economy or on plastics. The FTT, which in the years leading up to 2020 has been a decade-long topic of debate, has had its scope eroded and now involves increasingly less ambitious proposals, is an option to provide the state or European funds with a new revenue stream that will be absolutely vital in the years ahead. Moreover, the current proposal seriously undermines the role it could play in stabilising the markets and its power to raise funds.

The time has come to examine radical proposals that are up to the task of dealing with the situation facing us. This report will analyse the impact of an FTT on financial stability, market liquidity, economic growth and revenue collection. It will compare, based on different scenarios, the various options that have been discussed in recent years and their impact on the current market. It will assess the collection of this tax and its effects on some of the most speculative markets, such as high-frequency trading markets, or markets eluding public control, such as shadow banking.

An FTT's effects on the global economic system will also be investigated, along with how financial stability and the reduction of short-term speculative investments can benefit not only the EU Member States applying the tax, but also other countries or regions of the world that will benefit from global financial stability and the redirection of capital to investments with a long-term vision. It is not only the financial system operating in Europe that needs 'sand thrown at its wheels', but in the current crisis and in a fully financialised and globalised economy the action of the financial sector must be ringfenced and channelled instead into reducing the disconnect between the financial economy and the real economy. The EU must be the player that leads this global debate.

Based on the results of the analysis of the various proposals, conclusions will be drawn and recommendations put forward to guide the political debate and highlight the harm that could be done by agreeing on an FTT that does not meet the main goals required of it and that fails to achieve the expected and necessary results.

Executive Summary

- The current French/German proposal for the 10 countries in the enhanced cooperation process would raise less than €6 billion in total, while adopting the broad thrust of the 2013 proposal would mean that between €11 billion and €24 billion could be raised. If the 2011 proposal with its triple-A approach were currently implemented across the EU, between €21 billion and €62 billion would be collected across all Member States.
- Given the current economic and health crisis we face, the European Union must use all the means of levying taxes at its disposal. A Financial Transaction Tax (FTT), which has been widely discussed and which indeed is already being levied in several EU Member

States, could be an almost immediate source of revenue in this regard.

- This report looks at France and Italy, where the French/German FTT proposal has been applied but where it has proved unsuccessful in combating excessive risks relating to market speculation, financial stability, high-frequency trading and shadow banking. Failing to tax derivatives can lead to the simple relocation of capital and tax evasion, as well as losing the stabilising power they have over the economy.
- It has also been shown that this type of tax eliminates purely speculative financial operations and that such capital is redirected to long-term investments, which are now more necessary than ever to achieve an economic recovery that is accompanied by a change in the economic model.
- While public health services have been dismantled in many European countries due to austerity policies, the financial sector has still not made a contribution that is commensurate with the damage caused by the previous crisis. While citizens are suffering from the impact of the COVID-19 crisis, banks' value has already returned to pre-crisis levels, making it even more obvious that the financial sector must contribute to the economic recovery from this crisis through specific taxes on financial activity.
- The European Union must lead the global debate, given that it is most equipped to spearhead the implementation of such a tax at global level. In crises of the type we are currently experiencing, mechanisms that reduce market volatility and redirect capital to long-term investments that will help southern economies finance their way out of this crisis are more vital than ever.

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