



HOW MANY CHEERS FOR THE TOBIN TRANSACTIONS TAX?

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With this paper, the authors were trying to value all the possible effects of the financial transactions tax called “Tobin tax”.

The authors’ analysis was divided in three points just as the three logical foundations of this kind of tax:

1. the excessive volume of short-term transactions in foreign currency and their effects on the exchange rate volatility;
2. the potential revenue of the tax;
3. the eventual possibility for the national economic policy to become more powerful.

INTRODUCTION

The idea to impose a tax based on the financial transactions has generated a growing interest in the economic world since its first introduction, made by the Nobel Laureate James Tobin in 1974. Originally he had in mind a tax on all foreign exchange transactions, but during the years his original idea has changed a lot.

As said before, there are three different rationales that have been used to support this tax.

The first rationale:

- disproportionate volume of foreign exchange transactions
- 60 times greater than the volume required to an healthy financial trade.

It can generate negative consequences:

- Volatility in the exchange rate  negative effect on the real economy.

A tax would be useful to shift the transactions away from short-term expectations towards longer-term and more trade-oriented factors (presuming that under a floating exchange rate regime, limiting the volume of transactions would reduce this volatility).

The revenue-raising potential of a transactions tax provides the second rationale for such a tax.

“..logical source of funds for a global response to global threats is a set of fees on globally important transactions [...] is a tax on the international movements of speculative capital suggested by James Tobin who suggests a tax rate of 0,5% on such transactions, but even a tax of 0,05% could raise \$150 billion a year. Such a tax would be largely invisible and totally non-discriminatory.”

United Nations Human Development Report (1994)

Idea that the financial sector is relatively undertaxed.

- Taxes on the buying and selling of equity account on average for 1 – 3% of tax revenues on OECD (Organization for Economic Co-operation and Development) countries.

The application of this tax seems to generate lots of conflicts:

reducing the influence of speculation with the reduction of the volume of transactions	objective to raise revenues maintaining an high level of transactions
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The *third rationale*:

- enhancing the autonomy of national economic policy,
- reducing the constraints on such policy imposed by the financial markets.

This reasoning seems to be the opposite of the view that since financial markets “knows best” they exert a healthy regulation on central bank and governments.

The purpose of this paper is to assess the robustness of these three arguments focusing on two further issues which are not always given attention in the literature:

- if the transactions tax effects the elasticity of expectations,
- if a transactions tax discriminates on the basis of the length of time foreign assets are held.

VOLATILITY AND SPECULATION

In a flexible exchange rate regime, speculation may increase the volatility of both the nominal and real rate of exchange, whereas in the adjustable exchange rate system there is considerable stability in the nominal exchange rate, which, however is disturbed by considerable rate adjustments forced on the authorities by speculative pressure.

In Tobin's opinion, the transactions tax could be helpful in both the regimes – the fixed or the floating one.

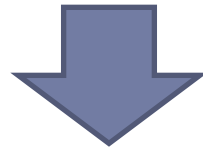
VOLATILITY : short-term instability.

It can be interpreted as small fluctuations around a fundamental equilibrium exchange rate.

➤ Inconvenient for those involved in international trade, because of the uncertainty which it creates.

As we have already seen, volatility engenders a degree of price uncertainty with the consequence of

➤ making effective decision-making more difficult.



Firms are more reluctant to engage in international trade and thereby reducing its volume.

SPECULATION can be defined as the act of buying or selling with the aim of benefiting from price movements. There are two traditions to explain this phenomenon:

- in the first one, the adjustment mechanism is simple: when price is above a equilibrium, speculators believe that the price will fall, and consequently they will sell to gain from the current high price; their actions effectively help the price to fall and move quickly to equilibrium;
- in the second one, there is more emphasis to the role of expectations. A price may be seen as high or low in relation to the equilibrium and may be interpreted as rising or falling independently. For the agents, it's important to understand the psychology of other agents. In this second tradition, a high price can be interpreted as a sign of further future rises.

A transactions tax would be expected to:

- reduce substantially short-term dealing, so that the tax..
- would reduce the volume of “noise trading” and..
- reduce the elasticity of expectations.

This change in the balance may help to enhance the stability of the foreign exchange market. There is some reason to think that a Tobin tax would, as a result, damp down volatility of exchange rates and under a fixed exchange rate regime make it somewhat easier for the authorities to defend the chosen parity.

TAX-RAISING POWER AND RESOURCE EFFECTS

The aim of this paragraph is trying to estimate what would be the revenues of the tax implementation. To do this is useful start with some figures.

	Daily average foreign exchange turnover (1992) (US\$ billion)	Daily average foreign exchange turnover (1995) (US\$ billion)
United Kingdom	290.5	464.5
United States	166.9	244.4
Japan	120.2	161.3
Singapore	73.6	105.4
Switzerland	65.5	86.5
Hong Kong	60.3	90.2
Germany	55.0	76.2
France	33.3	58.0
Australia	29.0	39.5
All others	181.9	246.2
Total of above	1076.2	1572.2

BIS estimates as reported in Felix (1996).

- \$ 1.08 trillion in April 1992 and became \$ 1.57 trillion in April 1995, this signified a growth of 50% in three years.
- Adjusted for cross-border double-counting and for gaps, results \$ 880 billion in 1992 and \$ 1.25 trillion in 1995.
- Considering 240 commercial days results in 1995 an annual turnover of \$ 300 trillion. This amount is around 60 times of the world trade in 1995 that it was \$ 5 trillion.

Potential tax yield: consider the possibility of tax evasion (problem of off-shore transactions), and the changing in volume of the transactions because the price-elasticity.

Effects: decreasing of the transactions because their increased costs.

➤ On the non-trade-related foreign exchange more substantial effects.

Aim: financial gain, from the exchange rate or from the differential rates of return.

Clearly, an increase of the costs is relevant for these actions.

➤ Short-term and long-term transactions: if the expected return is greater than the transactions costs involved, the capital flows are similar in both;

so that, speculation is profitable for any greater return's expectation than the costs (included the tax costs).

Reduce the speculation, doesn't depend on the short or long-term transactions, but on the frequency of the returns during the holding period.

➤ What tax rate?

- Little effect on the transactions and large yield. A 0.5% tax would yield \$ 1.5 trillion.
- But this is against the main aim of the tax, reduce the volume of transactions, it's suggested a tax of 0.1%, to have benefit on both, yield and less volatility.

Revenues: The authors believe that with a modest transaction tax, 0.1%, the revenues are about \$ 200 billion.

Resource savings: because less foreign exchange transactions.

➤ Example: transactions cost of 0.05% caused annual costs of \$ 150 billion.

According to the estimate that the volume of transactions would be halved and that the costs deriving from the taxation represent the resource costs, then the annual savings are of the order of \$ 75 billion.

POLITICAL REALITIES AND NATIONAL ECONOMIC AUTONOMY

There are always obstacles to the introduction of a tax. Here summarized in three categories.

1. The international coordination which would be required.
 - Widely agreement that is necessary an international coordination to the tax implementation, referred to its global characteristic.
 - It is not so important an agreement over the tax rate, at least a minimum rate to avoid competitive undercutting of the tax among countries.

The taxation yield instead, pertain to each single country and the crucial point is how these revenues have to be divided.

	% of daily average foreign exchange turnover (1992)	% of daily average foreign exchange turnover (1995)
United Kingdom	27	30
United States	16	16
Japan	11	10
Singapore	7	7
Switzerland	6	5
Hong Kong	6	6
Germany	5	5
France	3	4
Australia	3	3

BIS estimates as reported in Felix (1996)

If we take a look of the tab is clear that a larger amount would be for few countries. A proposal for a part of these profits could be the transfer to an international organization, whose work is developing purposes of the world economies, especially for the Third World.

2. The political power of the financial sector: an effect of such tax implementation could be the loss of influence by the financial sector.
3. General obstacles to increased levels of taxation.

The successful implementation of a transaction tax could be enhance the autonomy of the policy-maker.

The decrease of the transactions means greater reserves of Central Banks; it makes the intervention of Central Banks more effective, and could reduce the anxiety of the prevision of reflationary policies increasing again the effectiveness of such policies.

SUMMARY AND CONCLUSIONS

As a conclusion of this paper we could define the Tobin tax a useful instrument to decrease the volatility of the financial market, reducing short-term transactions and so speculative behaviours, it could also imply a sort of resource savings in the whole market.

The scope of this tax is include all the exchange of a financial asset denominated in one currency for a financial or real asset denominated in another.

It is necessary a world agreement over at least the minimum tax rate and the utilization of the profits.

The implementation of the tax may appear complicated but it is not really more complex than many other existing taxes. For example, if all the standards studied here had been used before imposing an income tax, it would never been introduced.

The tax has to overcome also political and technical obstacles for its implementation: e.g. off-shore transactions, derivatives.

THE TOBIN TAX TODAY

During these years, Tobin's originally idea has changed a lot and the Tobin tax applied since the 1st march 2013 in Italy is a different tax with also a different purpose from the first one. This tax, in our country, affects only a few transactions but it is expected that its use will be extended also to derivative securities from the next July.

Although its scope is limited, in a few days it has had big effects: the securities' turnover has dropped by a third (- 32%) after the introduction of the tax on financial transactions. The data comes from the U.S. investment bank Morgan Stanley.

The periods taken as a reference are those ranging from 2 January to 20 February (pre tax) and then from 1 to 15 March (i.e. 15 days after the introduction of the Tobin Tax).

[Source: www.milanofinanza.it]