

# Frequently Asked Questions

## FINANCIAL TRANSACTIONS (Robin Hood) TAX

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### 1. What is it?

#### What is a Financial Transactions Tax?

The Financial Transaction Tax (FTT) is a very small levy applied to various categories of financial transactions including: stocks, bonds and currency. The rationale of the tax is both to regulate the market/ reduce global financial instability and to raise revenues for domestic and international purposes.

#### Is there any precedent for it?

The UK stock exchange, one of the largest in the world, already has a small tax on share transactions. The rate of this tax, 0.5%, is between ten and fifty times higher than the current proposals for an FTT, and yet the UK stock exchange has not been significantly hampered or affected.

#### Is this the same as the Tobin Tax?

Almost forty years ago, American economist James Tobin proposed a small tax on foreign currency transactions as a means of bringing about stability to global financial markets. Support for the so-called 'Tobin Tax' waxed and waned through subsequent decades, but support for Tobin's idea started to gain traction again in recent years with research work showing the viability of a Currency Transaction Tax. James Tobin would later go on to be awarded the Nobel Prize for economics.

The rise of trading in so many new types of markets has made it necessary to extend the concept; if only one type of transaction is taxed (for example, those on foreign exchange), traders would simply move to another market to avoid paying the tax. Moreover, by extending

the breadth to the tax, it generates the potential for more revenue.

#### How would it work?

The tax would be relatively easy to implement, the main problem in fact not being a matter of technical implementation but of political will. It would be limited to transactions on financial markets only: consumer transactions such as payments for goods, paychecks and overseas remittances would not be taxed, nor would short-term inter-bank lending.

It would cover all transactions traded on foreign exchanges, as well as those traded off-exchange (also known as 'over the counter' transactions).

The optimal situation would be one where all the major financial centres agree to implement the FTT in simultaneous sequential steps, but it would be possible to implement the tax in some jurisdictions and not others. It could be implemented in the European zone and Japan, for example, without being implemented in the US zone, or vice versa, without a great deal of damage to the financial markets in either place. However, politically it would be easier if both the US and Euro zones chose to implement the tax.

Although, for simplicity, a flat rate of 0.05% has been proposed on all financial market transactions, many experts actually advise vary rates (of between 0.01 and 0.5%) depending on the transaction (stocks, bonds, currency, commodities, swaps, derivatives, etc).

#### Who would collect the tax?

The tax would be collected by the government responsible for operating a particular trading 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.

### Why now?

The FTT has been brought onto the international agenda for a number of reasons.

Firstly, computerisation of transactions has turned the logistics of collecting the tax from being quite complicated to very straightforward. Computerisation of trading has also made a tax on financial transactions more *necessary*: it is the very speed of the systems we now have that have contributed to the tremendous expansion of trading and of the finance sector as a whole, to a point where the sector no longer performs its social function efficiently. Nowadays, too much trading is done to make a quick profit, and not to serve the real economy. This high frequency trading has brought instability.

Secondly, the Global Financial Crisis has provided renewed impetus to push for an FTT. The crisis exposed as myths many of the ideological underpinnings used by the financial sector and its supporters to justify the exponential growth of financial trading in the years preceding the crisis. The most obvious fallacy was that the complex derivatives instruments helped bring more stability to the financial markets, when in fact the opposite was the case. In 2008, former Federal Reserve Chair and greatest defender of derivatives trading, Alan Greenspan, was forced to admit that he and many others had been wrong.

The banking sector, it is also felt, should be made to share the cost in repaying the public debt now owing as a result of the global financial crisis. Governments have had to spend billions of taxpayer dollars bailing out the banks themselves, in order to keep the global financial system afloat. In addition, governments have had to spend billions on fiscal stimulus packages to help kick start flagging economies, and although these packages haven't gone to the banks themselves, they were only necessary

because of the profligacy of the finance sector in causing the crisis.

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## 2. Costs and Benefits

### What are the benefits of the Tax?

(1) An FTT will reduce the instability in the global financial system by reducing the volume of trading in financial markets, especially the sort of trading that increases market instability and has led to the turbulence in the financial markets over the last decade.

(2) An FTT will provide an effective way of raising revenues for both domestic purposes, such as assisting governments help pay for the costs of post-financial crisis bailouts, as well as for spending for international public goods, such as the funds needed for climate change adaptation, and to assist countries in meeting the Millennium Development Goals.

### How will the FTT make the market more stable?

Short-term transactions encourage price runs and 'noise trading', both of which contribute to instability in the global economy. These would be reduced by an FTT. Price runs would become less pronounced and the boom and bust cycle that we have seen in recent years should become less pronounced.

### Which financial institutions would be most affected?

In recent years, the huge increase in size and speed of financial transactions has resulted in a situation where short-term investment periods have shrunk from years to days.

The tax is specifically designed to target *high frequency traders*, especially of securities, where the average holding period is often minutes or seconds. High-frequency traders currently account for 70% of US equity market

trading and 30-40% of the volume of trading on the London Stock Exchange.

The tax will only affect financial institutions and funds to the extent that they are involved in this type of high-frequency trading. Hedge funds will certainly be affected, as a great deal of their profitability comes from this activity. Investment banks such as Goldman Sachs will also be affected, although their exposure to the tax will decrease as new banking regulations come into place. Some operations of commercial banks will be affected, for example in bond markets.

It is possible that some of these losses will be passed on to consumers; however most of the impacts of the tax will be absorbed by the sector itself. Moreover, it is the wealthiest of investors who will receive the brunt of any 'pass on' affect.

### **How much revenue will be raised?**

If implemented on a global basis, its projected revenue could be as much as US\$400 billion a year, depending on the size of the levy imposed, the size of the reduction in trading (if any), and the number of implementing countries/jurisdictions. In the US alone it has been estimated that annually, between US\$177 and \$353 billion could be raised.

### **How would the revenues be spent?**

Decisions as to how to break down the spending of revenues would need to be decided through the implementation of a proper consultative process. The international coalition of groups campaigning for an FTT is proposing that the revenues be spent in the following way:

**50 per cent** of the money generated would go towards fighting the deficit and paying off the public debts in the country where the tax has been generated and in some of the other G20 countries;

**25 per cent** would go to meet the financing gap in helping developing countries achieve the

millennium development goals;

**25 per cent** would go to help developing countries adapt to and mitigate against the impacts of climate change.

### **Won't this tax be passed onto ordinary consumers and investors?**

The short answer is no. The bulk of the impact will be absorbed by the financial sector itself. The tax will cut into profits of institutions such as hedge funds and investment banks, as well as the large salaries received by financial sector employees.

While investment banks will in all likelihood pass some of the cost of the tax on to their customers (who tend to be large corporate entities), commercial banks should see their profitability affected very little, since they don't engage heavily in the type of transactions targeted by the FTT.

The tax will have little effect on the sort of funds used by the majority of investors, who are what is known as 'buy-and-hold' investors. With their money in facilities such as pension funds and mutual funds, they tend to turn their portfolios around less than once a year. Day traders or individuals who handle their own portfolios will similarly remain largely unaffected.

### **Will the tax impact on the important role that financial markets play?**

Financial markets play a vital social role in that they enable traders to 'hedge' – or bet for or against a certain outcome occurring. Hedging allows the markets to find the right price for a commodity, a currency or a stock. The enormous increase in the volume of transactions over recent decades, however, indicates that financial trading has gone well beyond its core function.

By providing a minor disincentive to short-term trading, an FTT will likely cause a small reduction in the volume of transactions in financial markets, perhaps to levels that were

present in the 1980s. Some opponents claim that this will make financial markets less efficient, but in fact, the 1980s was a period of vibrant and efficient capital markets.

### **Will the FTT be too hard to implement?**

No. Electronic systems used on all the main exchanges would make this relatively simple to implement.

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## **3. Making It Happen**

### **Who currently supports the FTT?**

The FTT has strong support in key European Union Constituencies. French President Nicolas Sarkozy, German President Angela Merkel and her Finance Minister are all strong supporters of the tax. British Prime Minister Gordon Brown has also announced his support.

The FTT has found support from influential members of the Japanese Government, including the Foreign Minister (and expected next President) Katsuya Okada.

President Obama has stopped short of endorsing the Tax, outlining plans instead to implement and Banker's responsibility fee. However, it is hoped that widespread campaigning by US civil society will enable the Obama Administration to change its position. House Speaker Nancy Pelosi has already endorsed the tax.

### **Why is the G20 Important?**

The most surefire way for an FTT to become a reality is for the G20 leaders to come to a broad agreement, and to negotiate together the best way to implement it globally.

While it isn't necessary that all jurisdictions implement the FTT, the optimal situation would be one where all the major financial centres implement the FTT in simultaneous sequential steps.

### **What is Australia's Position?**

The Australian Government is yet to express its support for an FTT. Embarking on an Australian Robin Hood Tax campaign, we hope and expect that this will change.

Australia is a leading player in global finance in its own right: the Australian Securities Exchange (ASX) is the ninth largest stock exchange in the world. Australian support of the FTT would be a significant boost to the cause of the global campaign. Moreover, Australia is a G20 country and plays a significant role in the group whose endorsement would effectively make the FTT a reality. Australia's endorsement of the FTT in the lead up to the 2010 G20 meetings and at the meetings themselves is very important. At the very least, we need to campaign to ensure that Australia does not play a blocking role in the G20.

### **Will the FTT hinder Australia from developing a strong finance sector?**

There is no inherent contradiction between the growth of the Australian Financial Sector and a Financial Transactions Tax; in fact, an FTT should make Australia a safe place for investors to do business.

The Australian Government hopes that the finance sector will grow in future years, buoyed by the perception that it is a safe pair of financial hands, since it was one of the few developed countries that did not go into recession during the crisis. Whether or not this growth occurs, Australia will not benefit if this encourages more high-frequency traders whose activity tends to create instability and benefit only the wealthiest investors and financial sector employees.