A Financial Transactions Tax (FTT) as an alternative to GST

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1. In New Zealand FTT has been proposed by the Democrats (Social Credit). When the Alliance was formed in 1992/93, with the Democrats as one of its constituent parts, it adopted a FTT and proposed to substitute it for GST. The rate proposed was $1 tax per $1,000 of all bank debits.

2. GST is a regressive tax, because people on lower incomes pay a much larger part of their income on food and other necessities than people on higher incomes. By contrast, FTT would weigh much more heavily on the budgets of people on higher incomes, because they use the financial system much more intensively.

3. FTT is a tax on all financial transactions as they pass through the financial system. The tax may be levied on all debits or an all credits or on the total of debits and credits flowing through the banking system. Naturally, the banks will pass on the tax to their customers. Although it would be possible to avoid the tax, the costs of doing so would be prohibitive in most cases.

4. It should also be said that the tax cascades. When steel is produced, FTT increases the cost. When blacksmiths use that steel, then they pay a price increased by FTT and when they sell what they have made out of it, they charge FTT on top of all their costs. Since in New Zealand we don't have long chains of production, and given the low rate of FTT, I don't think it would be a major problem.

5. FTT is not as outlandish as it sounds. Various Australian states have had FTTs for many years. In Victoria one has or used to have a Financial Institutions Duty Tax of 0.06% as well as a debit tax at varying rates. However, these were or are much more complicated to administer than an FTT with only one rate and which would be automatically applied by means of a computer programme to all bank debits. Belgium runs a limited form of FTT and its banks have not suffered.

6. The big question would be how much revenue FTT would yield? It could be much higher than GST. A prudent approach would start with a portion of the intended rate over a period, whilst GST would be removed from, say, food items. On the basis of that experience, a higher rate would be set for the next period, and so on.

The size of the tax base

7. Until the 1980s the total amount of financial transactions was about 8 times higher than Gross Domestic Product in most countries, including New Zealand. In response to the de-regulation of the financial sector, which started when the US Dollar became inconvertible into gold in 1971, followed by the floating of exchange rates in 1973 and a wave of deregulation of almost all economic sectors, but particularly of the financial sector during the 1980s, the volume of financial transactions mushroomed. Technological innovations such as the use of satellites and computerisation have stimulated this development enormously. The theory of efficient financial markets, meaning that prices formed reflect all available information and are, therefore, to be regarded as proper guides to investment, was used to justify speculation. Physicists and mathematicians have been engaged to harness the power of computers to take advantage of the slightest differences in prices around the globe.

8. In 1994 the New Zealand payments system turnover was already a multiple of 73 times the level of GDP.

FTT as a device to curb financial speculation

9. FTT drew attention when Tobin, a professor at Yale University, proposed, in 1972, that an FTT charged on international capital flows would discourage speculative flows of short-term capital, or as he put it, *throw sand in the wheels*, and, thereby, would help to stabilise exchange rates. In 1998, the Attac movement adopted FTT as part of its proposals to tax the rich and help the poor, and, curb speculative financial capitalism.

10. Even more recently, in December 2011, the European Union adopted the principle of FTT. However, there is still considerable debate about it. This means that the EU cannot implement it as yet. EU Commissioner Algirdas Semeta is working on an FTT that would yield up to Euro 57 billion (*Die Zeit*, 19 April 2012, p.36) and which would apply to transactions involving shares, bonds and derivatives (this is more limited than the FTT proposed by the Alliance). The article just referred to mentions that two third of the population of the EU is in favour of FTT.

How does FTT work?

11. As I hinted before, FTT has many variants. What they all have in common is that they are levied on volumes of financial transactions

and, given that these are traded in large volumes, the tax is set at a very low rate, for instance, at $1 per $1,000 or 0.001. Most recent proposals feature 5 cents per $100 of transactions.

12. Assume, for instance, that it is levied on all deals involving buying and selling of financial instruments such as shares, bonds and derivatives (options, term deals, swaps, etc.). At a rate of 0.0005, the tax on a sale worth $10,000 yields $5. I don't think this would deter profitable deals in shares or bonds.

13. Let us assume that somebody speculates on share prices rising within a day (Schulmeister, 2009: 35). He/she buys a term contract (put option) that will allow the purchase of a packet of shares, mirroring the stock market index, for $150,000. FTT is 0.0005. He/she must put up cash at a rate of 5% of $150,000 or $7,500. So, the leverage factor is 20. Let us assume that at the end of the day the share price index has increased by 0.2%. So, the dealer buys the shares for $150,000 and makes a profit of $300. FTT payable at 5 cents per $100 of transactions is $75. This takes away 25 percent of the speculative gain.

14. In general, the higher the leverage, the higher the frequency of dealing and the higher the volume of transactions, the higher the burden of FTT. FTT, therefore, would make speculation less attractive.

15. This is exactly its purpose because fast speculative trading destabilises the prices of shares, raw materials and rates of foreign exchange.

16. By the way, Oxfam has estimated that FTT of 5 cents per $100 of transactions on trading in equities, bonds, derivatives and forex transactions, if applied world-wide and allowing for some decline in speculative activity, would raise NZ$570 billion a year globally (Coates, 2010: B5). Such a sum could be used, according to Oxfam, to fund public services, combat poverty, support countries that have suffered from the financial crisis and tackle climate change.

17. A FTT might induce business corporations to invest capital in the production of useful goods and services rather than in making quick bucks by speculating.

The European Union's Proposal

18. Stephan Schulmeister, an Austrian economist, has estimated that an FTT of 0.0005 would yield 1.14% of the GDP of Germany or about Euro 27 billion, even if financial transactions were to decrease by 65% consequent on the introduction of FTT. In 2009 a broad range of organisations petitioned the Bundestag, the German federal parliament,

to introduce an FTT. It would raise revenue and would hinder the substitution of financial dealing for investment in production.

19. In the Northern summer of 2011, the G20 decided against the FTT. However, Chancellor Merkel wanted it, nevertheless. The new President of France, Francois Hollande, has also come out in favour of FTT. The rescue packages for Greece and other countries had cost lots of money and the re-regulation of the financial system was not progressing.

20. By means of an FTT the financial system should pay back part of the public funds spent to save them in the financial crisis of 2008 and beyond.

21. Mid 2011, a German official of the EU, economist and expert in industrial policy, Manfred Bergmann (2012: 23, 24), began work on FTT, along with 80 officials. He had just been promoted to Director of indirect taxes. So, he read the papers that EU officials had written against the idea of FTT. They argued that:

    a. every financial transaction raises productivity (speculation on movements in prices of gold, interest rates, swaps??)

    b. all investment is financed by shares and bonds (manifestly, not true).

    c. Financial transactions would move to Hong Kong, Singapore or the US.

22. Bergmann believes that the tax should be levied in the place where the corporation is registered. When a German bank buys a financial product from an American bank, FTT would be payable by both the German and the American bank. The American bank would have to pay the FTT to the German IRD. This was part of a bill prepared by the EU Commission to introduce FTT.

23. Of course, the proposal was opposed. In November 2011 a meeting took place in the German parliament (Bundestag). Some financial experts, employed by financial institutions, estimated that the tax would reduce the rate of economic growth (real GDP) by 1.76% p.a. This would trigger a loss of tax revenue of Euro 80 billion, well beyond the Euro 57 billion estimated to be returned by the proposed FTT. However, at that meeting Stephan Schulmeister took issue with the EU Commission's estimate of Euro 57 billion. He pointed out that the volume of trading in shares in Germany, England and the USA was 100 times higher than the volume of business investment. Should FTT result in more money being invested in the real economy rather than in financial speculation, then, the rate of economic growth would increase significantly. The experts debated these issues for three hours.

24. As a result, Bergmann and his staff checked their calculations again as thoroughly as possible, by paying attention to the fact that not every real investment is financed by shares or bonds and that not every financial investment has an effect on the real economy. The conclusion was: the effect of FTT on the real economy would be nil. Should the revenue be invested wisely, it could indeed induce a higher rate of economic growth.

25. Some objections concerned compulsory financial investments in retirement packages. Somebody who saved Euro 100 a month for 40 years would lose Euro 14,000, assuming that every financial title would be sold and replaced by another at least once a year. Bergmann argued that the simple solution to this would be to keep the papers much longer.

Wider issues

Machines rule the world

26. There is no doubt that FTT could be implemented and that it would curb financial speculation with real benefits for society. Opposition will come from those who benefit from financial speculation. They believe that finance or money working through financial markets provide the right indicators for economic dispositions. The world is seen as a machine. Those who know how to operate it make money and become rich. Those who don't miss out on the good life through their own fault. This view of the world is especially wide-spread in Anglo-Saxon countries. It is a view which has given rise to a hypertrophy of the financial system. Banks have become financial conglomerates with things like special investment vehicles, fiscal paradises, hedge funds, mutual funds etc.

27. Supercomputers are a key tool used in financial speculation. When, in 2001 the SEC in the US reduced the smallest amount that could be traded from 16 cents to 1 cent, it became possible to harness the power of supercomputers. The abolition of the Glass-Steagall Act of 1931 in 1999 had already extinguished the separation of commercial banks and investment banks. As a result, Goldman Sachs was able to become a financial institution rather than just an investment bank. They bought warehouse space around the world as an aid to speculation on raw materials, including food (Kohlenberg et al, 2011:18). Financial markets as well as markets in raw materials are ruled by supercomputers, programmed by mathematicians and information science specialists: 'machines have taken over the world'. Prices as established by these machines are out of kilter with the real world where people live.

28. In contrast to the Anglo-Saxon fascination with debt, European firms are often small, highly specialised manufacturers of machinery, which is exported across the globe. People value training and education. Families are small. The ageing process is well advanced. Financial speculation easily ruins such firms. Share markets have never been as important as they are in the USA or England. Hence, debts are lower as a percent of GDP. However, the Anglo-Saxon ways have made inroads in countries such as Ireland, Iceland and Spain.

29. When a financial/economic system is governed by algorithms executed at the speed of light by super computers, one should not be surprised about the occurrence of financial crashes.

30. We should also be aware that the take-over by machines has been aided and abetted by a neo-liberal ideology shared by political/financial elites around the world. This involves ideas such as: markets know best, the private sector is more productive and efficient than the state, international trade should be entirely free so that specialisation can yield a maximum of benefits.

31. The financial system has become self-referential. In 2008 financial transactions in the world were a multiple of 60 times world-wide GDP. Another way of putting this is that there is a huge amount of debt. In the US total debts were 349% of GDP in 2008, compared with 155% in 1980 (Chesnais, 2011:70). Private debts have been found essential to compensate for falling consumption due to higher unemployment and lower wage rates.

Three intertwined crises

32. Under globalisation there has been not only a major expansion in productive capacity around the world, resulting in over-production, but also strong downward pressure on wage rates (with the exception of top people in business and finance). Under capitalism what is produced must also be sold. If wages decline and unemployment rises, sales lag behind and a crisis erupts. One can see this in the USA. The availability of sub-prime mortgages led to an over-production of houses.

33. In the real economy there is over-capacity, unemployment, hunger suffered by 1 billion people, environmental degradation and a growing impact of climate warming.

Illegitimate debts

34. When debts are contracted against the interests of the population of a country (state), without their consent, but with the full co-operation of

the creditors, then, such debts are illegitimate. In Greece the regime of colonels borrowed heavily (1967-1974). On the return of elected governments corruption became endemic and led to the contracting of debts. Owners of fleets should not pay tax according to the constitution.

35. It should be possible to wipe such debts. Those who lose their life savings could be compensated from the revenues of an FTT.

36. There have been a number of precedents of official debts being nullified (Lemoine, 2012: 4).

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This paper is available online at www.converge.org.nz/pma/ftt.htm