



# **Financial transaction taxes: part of the post-crisis toolkit?**

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## **Key questions**

What are the objectives of FTTs?

What are the possible problems of FTTs?

What are the possible alternatives to FTTs?



# FTT: Swiss Army knife for fixing the financial sector?

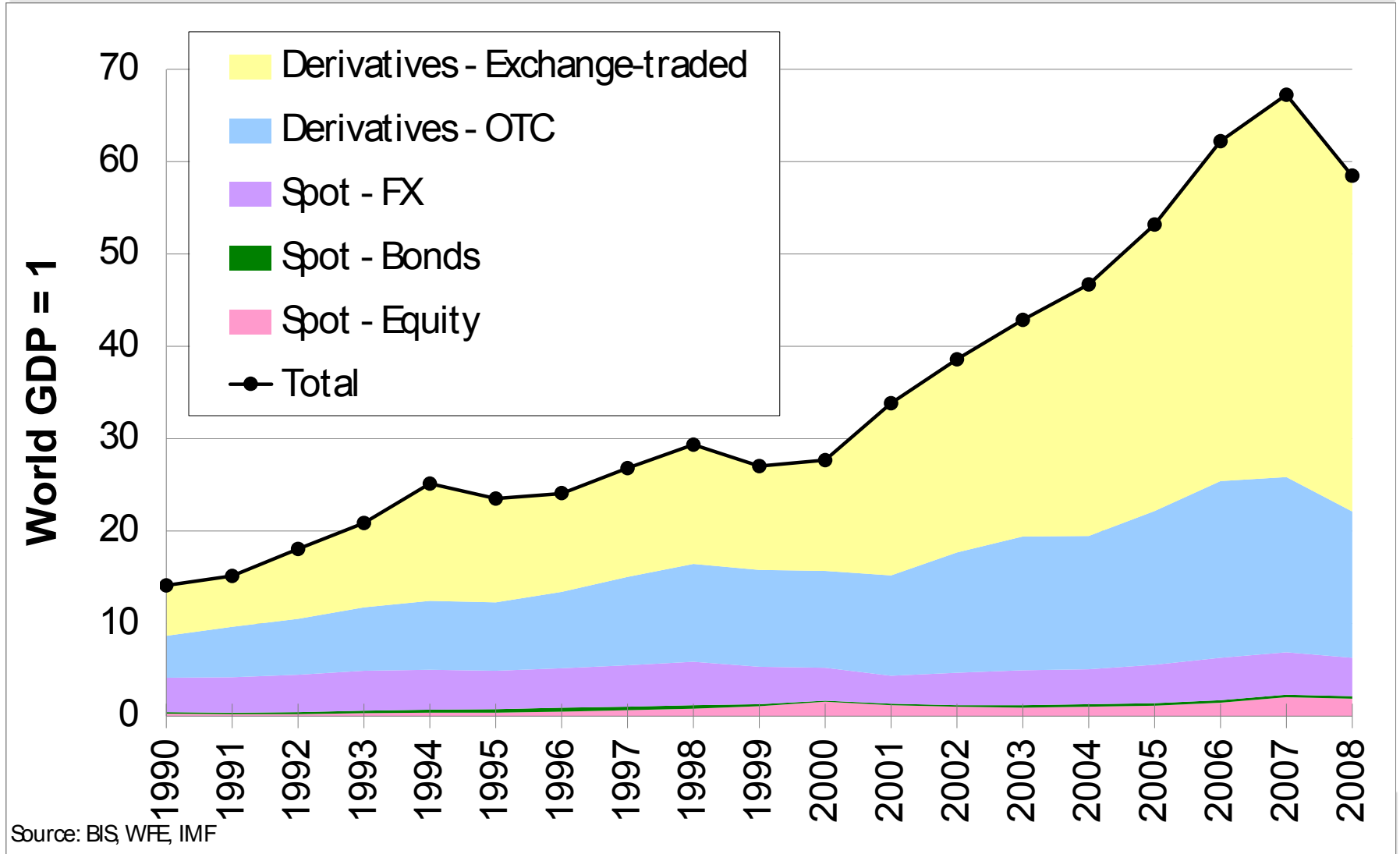
## Tools and Objectives

<b>Possible Objectives Possible</b>	Curbing socially useless speculation	Internalising costs of bail-out	Reducing fragility of fin. system	Raising funds for global purposes	
<b>Toolkit</b> Financial transaction tax					
Increased capital requirements					
Improved banking supervision					
Taxes on fin. sector profits and bonuses					

**Hardly - but quite possibly a useful addition to the toolkit.**



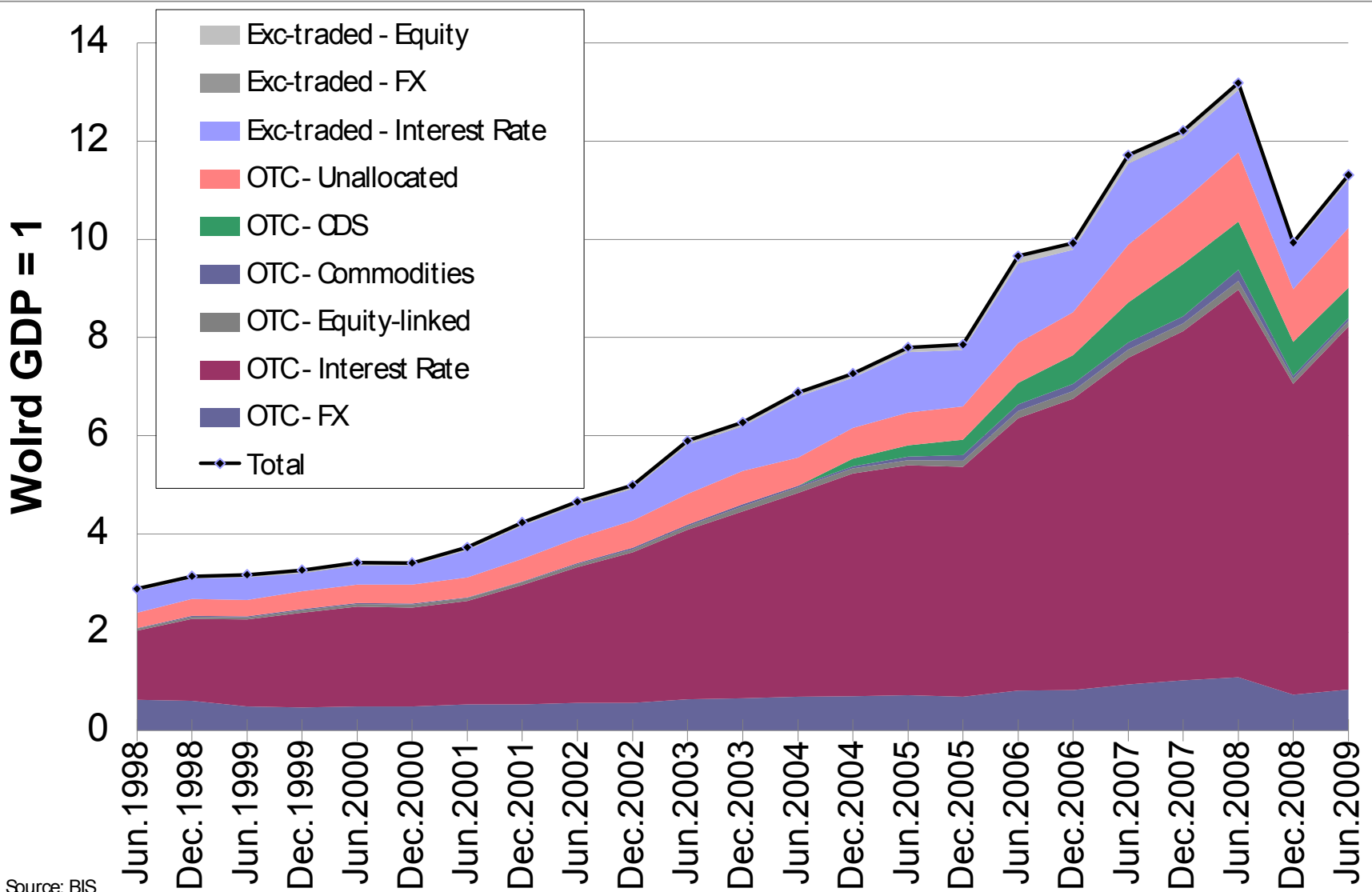
# Volume of financial transactions, 1990-2008



Source: BIS, WFE, IMF



# Derivatives – Notional outstanding amounts, June 1998-June 2009



Source: BIS



## Financial transaction tax: real life examples

- Countries with FTTs on stocks: e.g. Belgium, UK, US, Argentina, Brazil, Hong Kong, India, South Korea
- FTTs on corporate and government bonds: e.g. Argentina, Belgium, Brazil, South Korea
- Some FTTs on futures
- Workable even at national level but some unhappy experiences (e.g. Sweden)



## Effects on liquidity and volatility

- FTT tend to (substantially) reduce liquidity. Good or bad?
- Opponents of FTT: Liquidity is needed for the efficient processing of information and price discovery; a decline in liquidity would hinder the efficiency of markets, increase volatility and hurt the real economy.
- Advocates of FTT: An important part of short term speculation is costly yet of little use socially; by making short horizon trading more costly, liquidity is reduced from undesirably high levels while long-run volatility is unlikely to increase and might even decrease.
- Empirical literature remains inconclusive.
- FTT unlikely to result in devastating liquidity or volatility effects (return to transaction cost and liquidity levels of the early 2000s)



## Effects on the cost of funding

- Some evidence that FTTs led to a fall in share prices. As a result, raising of additional capital could become more costly.
- Also, FTTs would tend to increase the cost of risk management of non-financial firms, possibly leading to more risk-aversion in real investments.
- However, the experience of the stamp duty in the UK suggests that these effects were not sufficiently strong substantially to have hurt the London financial hub or UK companies



## Avoidance and evasion

- The ease of avoidance and evasion depends on design features of FTTs (eg UK vs Sweden)
- Staggered rates could incentivise financial institutions to move from OTC to centralised clearing and more standardised products.
- But the extent to which transactions might be diverted towards low-tax regions and innovative instruments may typically be hard to predict even when the FTTs are designed well.



## **Crisis of confidence and a shifting burden of proof.**

Are we convinced beyond reasonable doubt that FTTs are the best response to whatever problem they are meant to solve?

Are we convinced beyond reasonable doubt that FTTs must not be part of our post-crisis toolkit?