

Is the Financial Transaction Tax (FTT) a Good Idea?

Nobel Prize Winner, James Tobin, proposed a tax on foreign exchange (forex) transactions in order to throw 'sand into the wheels' of finance. He believed that there was excessive, socially unuseful, trading and that too many bright young people were becoming forex traders. Advocation of taxing a wider range of financial transactions, a Financial Transactions Tax (FTT), has grown as financial transactions have proliferated over the years and Lord Adair Turner, Chairman of the Financial Services Authority (FSA), has echoed Tobin in alleging much of the trading in financial markets to be socially useless. In 2011, the EU proposed the imposition of an FTT in the EU. The City of London is strongly opposed and the Prime Minister, David Cameron, has vowed to protect the City from vindictive EU regulation and the FTT in the interests of the UK economy. Is he right to do so?

The City and the wider financial sector, clearly does contribute considerable tax revenue to the UK and yet the government is committed to 'rebalancing' the economy to reduce dependence on the City in the wake of the Global Finance crisis. Further, 52% of City buildings are now owned by overseas interests, many in the EU. More importantly, the share of the City financial markets controlled by UK banks and other financial institutions is much smaller than that of European institutions and those for the US and Asian countries. The City is pre-eminently an international financial centre, and the largest one in Europe. The European Union countries thus have a vested interest in its competitiveness and a right to assure it is properly regulated to underpin financial stability, and the City benefits from UK's membership of the EU.

Is a FTT a good idea? Its aim is to raise revenue and reduce wasteful financial transactions. It will in fact reduce revenue from current levels; especially in the UK, if it does succeed in reducing wasteful transactions; but this will release resources for employment elsewhere,

facilitating re-balancing. However, the European Commission itself estimates that the net effect will be a reduction in the EU's economic growth. Further, it is not clear what the revenue would be used for. Proposals include the funding of aid for poverty reduction (a 'Robin Hood' tax) and financing financial sector supervision. Alternatively, it can simply be used to fund general government expenditure. One reason for the net cost is that, unless the US and other countries also adopt an FTT, and there seems little chance that they will, the tax will drive business from London to New York and elsewhere.

Recent reports on how to improve the UK tax system ('The Mirrlees Review') and the Australian tax system ('The Henry Report') argue that transactions taxes, such as UK's 'Stamp Duty' on company share and house sales, are inefficient and distortionary. Both reports argue that it is better to introduce a Value Added Tax (VAT) on financial products and services and so the EU and the UK should consider this alternative proposal seriously.

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