

## Executive Summary

*The term “Tobin taxes” may be thought of as a general reference to taxes imposed upon financial transactions. Tobin or transaction taxes are motivated by the prospect of generating revenue; and, the prospect of dampening speculative activities and reducing market volatility. This article provides a review of actual experience in the context of the New York Eurobond markets, Japanese stock markets, Swedish financial markets, Taiwan futures markets, U.K. stock markets and U.S. futures markets. The evidence generally refutes the concept that Tobin or transaction taxes result in significant revenue collections or mute volatility. When applied in practice, such taxes resulted in diminished liquidity, increased higher volatility and detracted from the price discovery function. Further, such taxes tended to create a “tax arbitrage,” driving financial business to alternate trading venues, resulting in insignificant revenue collections.*

**Introduction** - The Bretton Woods Agreement, adopted in July 1944, established a system featuring fixed currency exchange rates. The lynchpin of the system was convertibility of the world’s major reserve currency, the U.S. dollar, into gold at a fixed price. By 1971, however, financial stresses caused the system to break down and currency values were generally allowed to float freely one against the next.

It was against this backdrop, and based on fears of currency instability, that Nobel Laureate economist James Tobin proposed the imposition of taxes on spot currency transactions since 1972. These taxes were proposed for the purpose of encumbering speculation in currencies and, presumably, to mute volatility as well as to raise revenue. Since Tobin’s original proposal, the concept of “Tobin Taxes” on many different financial markets have been proposed, debated, studied and occasionally enacted, albeit never in the context of spot currency transactions.

Within the past year, German Chancellor Angela Merkel spoke publicly in favor of a Tobin tax. Former U.K. Prime Minister Gordon Brown is also in favor of such a tax. U.S. Representative Peter DeFazio (D-OR) made similar proposals but failed to clear the concept through Congress. Finally, the European Parliament approved a resolution to consider a Tobin tax in March 2010.

This renewed interest is prompted by the so-called subprime mortgage crisis of 2008. These proposals are further motivated by the prospect of recovering some of the costs associated with government bailouts from the financial sector; and, an earnest wish to find a mechanism to prevent future occurrences of a similar nature.

The development over the last decade of fully automated or “algorithmic” trading mechanisms has added some impetus to proponents of Tobin taxes as

a mechanism to throttle “high-frequency trading” (HFT) practices.

But in the rush proactively to address the situation, caution must be exercised to avoid damaging vital market mechanisms. Thus, we review Tobin taxes from an historical perspective. Further, we provide a review of the literature studying the impact of such taxes. The literature is instructive as it generally suggests that Tobin or transaction taxes detract from market liquidity and do not effectively serve to mute volatility. The impact upon revenue collection was generally negative and these taxes frequently served to drive financial business to alternate trading venues.

**Tobin’s Concept** – Nobel Laureate economist James Tobin suggested the concept of transaction taxes on spot currency transactions in 1972 during an Eliot Janeway Lecture at Princeton University. Actually, Tobin was simply reviving a proposal from the preeminent economist John Maynard Keynes who proposed a financial transaction tax during the midst of the Great Depression in 1936. Tobin’s concept was less generalized and confined to the spot FX or currency markets as a means to curb speculative activities therein. He further suggested that the monies collected be channeled in support of third world economic development or to fund the United Nations.

Tobin explained his dual motives in the forward to a 1996 book ... “The first is to make exchange rates reflect to a larger degree long-term fundamentals relative to short-range expectations and risk. My second objective is to preserve and promote autonomy of national macroeconomic and monetary policies.”<sup>1</sup>

Tobin elaborated that “currency exchanges transmit disturbances originating in international financial

---

<sup>1</sup> Tobin, J., “Prologue”, in M. ul Haq, I. Kaul, and I. Grunberg (eds.), The Tobin Tax – Coping with Financial Volatility Oxford University Press (1996)

markets. National economies and national governments are not capable of adjusting to massive movements of funds across the foreign exchanges, without real hardship and without significant sacrifice of the objectives of national economic policy.”<sup>2</sup> Tobin identified two alternate ways of addressing these problems including the adoption of “a common currency, common monetary and fiscal policy, and economic integration”<sup>3</sup> while the second solution might be to allow “central banks and governments greater autonomy in policies tailored to their specific economic institutions and objectives.”<sup>4</sup>

While Tobin preferred the concept of a common global currency and economic policies, he recognized the impracticality of such a proposal. Rather he recommended the second concept further proposing that governments “throw some sand in the wheels of our excessively efficient international money markets” by taxing spot currency transactions.<sup>5</sup>

Tobin believed that the tax must “be an internationally agreed uniform tax, administered by each government over its own jurisdiction. Britain, for example, would be responsible for taxing all inter-currency transactions in Eurocurrency banks and brokers located in London, even when sterling was not involved. The tax proceeds could appropriately be paid into the IMF or World Bank. The tax would apply to all purchases of financial instruments denominated in another currency ... It would have to apply ... to all payments in one currency for goods, services and real assets sold by a resident of another currency area.”<sup>6</sup>

Tobin was frequently vague regarding the optimal rate for transaction taxes. However, he did suggest, in an interview appearing in *Der Spiegel* in 2001, a rate of 0.5%.<sup>7</sup> Other economists have, over the years, proposed rates ranging from 0.1% to 1%. But when studies have been conducted that incorporate actual market data, the prescribed rate has generally been much lower.

**Practical Considerations** – Much criticism has been directed at the concept of a Tobin tax based on

<sup>2</sup> Tobin, J., “A Proposal for International Monetary Reform” *Eastern Economic Journal* (July/October 1978).

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

<sup>7</sup> “James Tobin: ‘the Antiglobalization Movement has Hijacked my Name’” *Der Spiegel* (September 3, 2001).

its feasibility. In particular, these questions center about ... (i) the practical difficulties in monitoring transactions that should be subject to the tax and in collecting such taxes; and (ii) the extent to which nations must coordinate such taxes to avoid either expatriation of significant financial business or the creation of “tax arbitrage” opportunities.

Certainly it is very feasible to apply a tax on centrally traded financial products such as those offered on an exchange. Managing Director of the IMF Dominique Strauss-Khan, however, suggests that “transactions ... [in over-the-counter markets such as the interbank currency market] ... are very difficult to measure and so it’s very easy to avoid a transaction tax.”<sup>8</sup>

But others disagree regarding the feasibility of monitoring and collecting such taxes. Nobel Laureate and former Chief Economist of the World Bank Joseph Stiglitz recently suggested that such tax “is much more feasible today” than when originally proposed by Tobin.<sup>9</sup> Stiglitz went on to suggest that such a tax should be applied to all asset classes in an effort to pay for the damage inflicted on less developed economies.

It is noteworthy that the Dodd-Frank legislation calls for the development of repositories in which data regarding over-the-counter derivatives transactions may be collected and analyzed. To the extent that similar provisions may be enacted in other nations, it becomes increasingly clear that modern technology is likely up to the challenge of monitoring even off-exchange transactions in support of Tobin tax collections.

A further question revolves around the extent to which such taxes must be adopted across various jurisdictions to become effective. Further, whether the imposition of such taxes may result in significant “tax arbitrage” as trading concerns direct their business to jurisdictions that do not impose such taxes.

One researcher has suggested that “[i]t is possible for a single country to apply a securities transaction tax unilaterally without significant capital flight ...

<sup>8</sup> Transcript of Press Conference by IMF Managing Director Dominique Strauss-Kahn with First Deputy Managing Director John Lipsky and External Relations Director Caroline Atkinson. Istanbul, Turkey (October 2, 2009)

<sup>9</sup> “Stiglitz Urges Finance Tax on Economy’s ‘Polluters,’ Calls for Tobin Tax on All Financial Trading Transactions” [www.bloomberg.com](http://www.bloomberg.com) (October 5, 2009).

examples of such taxes already in existence ... [include] ... Britain levies a 'Stamp Duty,' a 0.5% tax on purchases of shares of UK companies whether the transaction occurs in the UK or overseas. Such specific financial transaction taxes exist in Austria, Greece, Luxembourg, Poland, Portugal, Spain, Switzerland, Hong Kong, China and Singapore. The state of New York levies a stamp duty on trades taking place on both the New York Stock Exchange and NASDAQ." <sup>10</sup>

The inescapability of such taxes is undeniable in the context of instruments, such as U.K. stocks, which are registered by central U.K. authorities and where ownership changes are clearly recorded. However, as detailed below in practical case studies, these taxes, however inescapable, may exert other unintended and undesirable consequences.

However, others suggest that where the same or similar instrument may be traded in an alternate venues which do and do not impose transaction taxes, "trading would tend to migrate to ... [the] ... non-taxed jurisdiction, which may well be less regulated ... or participants could use other financial vehicles to achieve the same end." <sup>11</sup> Certainly the practical case studies detailed below support the prospect of expatriation of financial business or of tax arbitrage.

**Practical Market Experience** –It is instructive to review practical market experiences with Tobin taxes. Towards that end, there is a wealth of studies based on such experiences in various jurisdictions ranging from the U.S., Japan, Sweden and Taiwan. While these transaction taxes were never directed towards spot currency transactions, they nonetheless represent useful case studies.

These experts generally suggest that such taxes generally exert a deleterious impact on market efficiency and local economies by increasing the cost of market participation. Specifically, financial transaction taxes tend to ... (i) damage market liquidity and volumes; (ii) increase market volatility; (iii) detract from the price discovery function; and (iv) motivate traders to migrate activity to more

competitive foreign trading venues, resulting in reduced tax receipts in the long-term.

**Eurobonds in New York** – The Eurobond market first emerged about 50 years ago when New York quickly established itself as the epicenter of Eurobond trading. But in 1963, the U.S. government imposed the U.S. Interest Equalization Tax (IET). The net effect was that, while the Eurobond market continued to flourish, trading activity migrated to Europe.

Feldstein (1988) explains that "[d]ifferential regulation between offshore and onshore securities activities played a key role in stimulating the development of the [Eurobond] market. In 1963, the United States adopted the so-called interest equalization tax, effectively an excise tax on American purchases of new or outstanding foreign stocks and bonds. To no one's surprise, the IET effectively closed foreigners' access to the U.S. bond market; to the surprise of some, the market simply migrated offshore to London and Luxembourg. Other costly U.S. regulations (further international capital controls and a 30 percent withholding tax on interest payments to foreigners) nurtured the environment for the Eurobond market [in overseas venues]." <sup>12</sup>

Trading of Eurobond issues in London increased from \$148 million in 1963 to \$2.7 billion by 1970. Jobs in New York were lost and U.S. tax revenues were ultimately eroded.

The Fed acknowledged this state of affairs in 1969 ... "[w]hen the Euro-bond market first emerged in 1963, it was used primarily by a few European institutions and by private and public borrowers ... which, prior to the imposition of the United States interest equalization tax, had relied on the New York market for funds." Subsequent to the imposition of the IET, Eurobonds were "channeled almost entirely through those European countries which do not impede the flow of funds by way of exchange controls or tax laws." <sup>13</sup>

By 1974, the IET was repealed but the damage was done, the opportunity was lost and Europe remains the epicenter for Eurobond trading.

<sup>10</sup> Schmidt, R. "Notes on the Feasibility and Impact of a General Financial Transactions Tax; Civil Consultation with the IMF on 28 January 2010" [www.imf.org](http://www.imf.org) (June 24, 2010)

<sup>11</sup> "The Introduction of an International Financial Transaction Tax" TUAC 123<sup>rd</sup> Plenary Session – Item 7 of the revised agenda: World economic crisis, Action on taxation. Paris (November 12, 2009).

<sup>12</sup> Feldstein, Martin S., The United States in the World Economy University of Chicago Press (1988)

<sup>13</sup> Greene, Margaret L., "Growth and Retrenchment in the Euro-Bond Market" Federal Reserve Bank of New York Monthly Review (August 1969)

**Japanese Experience** – Japan has had a lengthy history of securities transaction taxes dating back to 1953. These taxes have been adjusted many times over the years, often in concert with adjustments in capital gains taxation rates.

The economic impact of adjustments to stock transaction taxes in several jurisdictions including Japan as well as Hong Kong, Korea and Taiwan was examined by Hu (1998). The study generally was inconclusive, finding that “[o]n average, an increase in tax rate reduces the stock price but has no significant effect on market volatility and market turnover ... Overall, the evidence is not consistent with the hypothesis that stock transaction tax can reduce noise trading and volatility.”<sup>14</sup> *I.e.*, adjustments to transaction costs do not appear to be an effective policy tool to reduce market volatility.

Shvedov (2004) found that Japanese security transaction taxes succeeded in raising significant tax revenues at least temporarily ... “the [tax] generated 4.2% of government general account revenue in Japan in 1988. However, by 1993 this share fell back to 0.96% as most of the speculative trading moved to the trading floors in much-less-taxed locations.”<sup>15</sup>

Liu (2007) studied the effects of a reduction in Japanese security transaction taxes in 1989 by examining the performance of equities listed on the Tokyo Stock Exchange. The study found “significant decreases in estimates of the first-order autocorrelation in returns for Japanese stocks listed in Japan, but no changes for Japanese stocks dually listed in the United States as American Depository Receipts (ADRs), which were not subject to the tax law change. We also find lower price basis between the ADRs and their underlying Japanese stocks. These results are consistent with the hypothesis that a reduction in transaction costs improves the efficiency of the price discovery process.”<sup>16</sup> Liu attributes this result to the fact that reduced transaction costs bolster activity and facilitate

quicker assimilation of market information into stock values.

**Swedish Experience** – Sweden enacted securities transaction taxes in 1984 and increased them in 1986. Interestingly, these initiatives were motivated, not by any particular market-driven factor, but by “envy in the country’s labor sector. The salaries earned by young financial professionals were unjustifiable, it was argued, in a society giving high priority to income equality.”<sup>17</sup>

Sweden had introduced a 0.5% tax (per side) or 1% (round-turn) on equity transactions in January 1984. The rate was doubled to 1% (per side) or 2% (per round-turn) in July 1986. A tax of 0.002% (per side) was applied to fixed income securities with a maturity of 90 days or less in January 1989; and, a 0.003% tax (per side) on notes or bonds with maturities of 5+ years.

Revenues proved to be far below expectations. Proponents of the tax expected annual collections of 1,500 million Swedish kroner (SEK) from fixed income securities. However, receipts averaged SEK 50 million and never exceeded SEK 80 million. The taxes had a deleterious impact upon taxable trading volumes as well as capital gains tax revenues. Swedish share prices generally fell 2.2% on the day that the tax was announced and 5.35% in the month prior to announcement, noting mounting expectations. Share prices fell another 1% when the tax was increased. The impact on fixed income trading was even more dramatic than the impact on stock trading as bond volume fell 85% during the first week that the tax was applied. After the taxes were abolished in 1991, trading volumes and tax revenues began to increase substantially.<sup>18</sup>

Umlauf (1993) studied the economic impact of these developments and concluded that “[v]olatility did not decline in response to the introduction of taxes although stock price levels and turnover did. Large proportions of trading activity migrated overseas to London when the tax rate was increased.”<sup>19</sup>

Habermeier and Kirilenko (2003) reinforced the earlier findings of Umlauf’s indicating that these “securities transaction taxes ‘throw sand’ not in the

<sup>14</sup> Hu, Shing-yang, “The Effects of the Stock Transaction Tax on the Stock Market – Experiences from Asian Markets” Pacific-Basin Finance Journal Volume 6, Issues 3-4, (August 1998)

<sup>15</sup> Shvedov, Maxim, “Transaction Tax: General Overview” CRS Report for Congress. U.S. Library of Congress, (December 2004)

<sup>16</sup> Liu, Shinhua, “Securities Transaction Tax and Market Efficiency: Evidence from the Japanese Experience” Journal of Financial Services Research Volume 32, Number 3 (December, 2007)

<sup>17</sup> Umlauf, Steven R., “Transaction Taxes and the Behavior of the Swedish Stock Market” Journal of Financial Economics 33 (1993)

<sup>18</sup> Campbell, J and Froot, K. “International Experiences with Securities Transaction Taxes” NBER Working Paper No. 4587 (December 1993).

<sup>19</sup> *Ibid.*

wheels, but into the engine of financial markets. We conclude that transaction taxes can have negative effects on price discovery, volatility, and liquidity and lead to a reduction in the informational efficiency of markets.”<sup>20</sup>

**Taiwan Experience** – Taiwan’s experience with a Tobin tax imposed on futures is both dramatic and very telling. Taiwan enacted a futures transaction tax in 1993 and the Taiwan Futures Exchange (TAIFEX) witnessed an immediate decline in trading volume, which was largely picked up by the Singapore Exchange (SGX). Subsequently, Taiwan cut these taxes by 80% and TAIFEX volume increased 300%.

Chou and Lee (2002) performed empirical tests “on the differences in trading costs and information transmissions between SGX and TAIFEX ... both before and after the tax reduction. It is shown that the reduction in the transaction tax greatly improves the efficiencies of price execution.”<sup>21</sup>

Chung, Liu, Wu and Yang (2003) studied the impact of the reduction in the futures transaction tax on market performance of the TAIFEX. They explain that “[a]longside an examination of the various impacts on market liquidity, volatility and government tax revenues arising from the transaction tax reduction, we also test the relative pricing efficiency of the ‘cost of carry’ model in both the pre- and post-tax reduction periods. Furthermore, in order to provide an insight into the growing competition between closely related index futures, we also examine the spillover effects of the transaction tax reduction on the trading volume of its foreign competitor, the Singapore Exchange (SGX). Our results indicate that the reduction in the tax rate has improved both the liquidity of the index futures and government tax revenues. We find that a reduction in transaction costs increases the public quote depth of an order-driven market, such as the TAIFEX. In addition to the reduction in volatility in the futures market, the tax reduction is also shown to mitigate the extent of prevailing pricing errors. We also find that the transaction tax reduction has led to an increase in the long-run growth of the trading volume in the TAIFEX, whilst reducing its foreign competitor’s growth rate of the trading

volume. Our results therefore support the hypothesis that a reduction in transaction costs increases the competitiveness of the futures exchange.”<sup>22</sup> To summarize, reduced trading costs increase market competitiveness and competition benefits everyone.

Chou and Wang (2006) tested the effect of this policy change on trading volumes, bid-offer spreads and volatility. Their findings “show that transaction taxes have a negative impact on trading volume and bid-ask spreads, as we find that trading volume increased and bid-ask spreads decreased in the period following the reduction in the transaction tax. Our analysis is not consistent with the argument that the imposition of a transaction tax may reduce price volatility, since there are no significant changes in price volatility after the tax reduction. We further find that, although the reduction in the transaction tax did reduce tax revenues, the proportional decrease in tax revenues is less than the 50% reduction in the tax rate. Finally, tax revenues in the second and third year after the tax reduction increased, as compared to the year before the tax reduction.”<sup>23</sup>

**UK Experience** – The United Kingdom imposes a stamp duty on the purchase of equity shares and debentures. This duty cannot be escaped by trading the instruments overseas because it is a tax on the change of ownership of UK registered instruments. This underscores a significant difference between stock and registered debt instruments and futures, noting that the structure of a futures contract readily may be replicated in many different venues.

Saporta and Kan (1997) investigated “the effects of stamp duty ... on the level and volatility of equity prices. We examine the response of the equity market to announcements in changes in stamp duty rates and we compare the prices of two assets which are similar in all respects apart from their treatment for stamp duty purposes: American Depository Receipts (ADRs) and their London Stock Exchange-traded stocks. Our findings are consistent with the hypothesis that stamp duty is capitalized in prices. Using univariate GARCH models, we find that stamp duty has no effect on volatility, contradicting the key

<sup>20</sup> Habermeier, Karl; A.A. Kirilenko, “Securities Transaction Taxes and Financial Markets” IMF Staff Papers, Vol. 50, Special Issue (2003)

<sup>21</sup> Chou, Robin K.; Lee, Jie-Haun, “The Relative Efficiencies of Price Execution between the Singapore Exchange and the Taiwan Futures Exchange” The Journal of Futures Markets Vol. 22, No. 2 (2002).

<sup>22</sup> Chung, Huimin; Liu, Mei-Ying; Wu, Soushan; Yang, Fu-Ju, “Transaction Costs and Trading Activity in the Index Futures Market: The Case of the Transaction Tax Reduction in Taiwan” EFMA 2003 Helsinki Meetings.

<sup>23</sup> Chou, Robin K.; Wang, George H.K., “Transaction Tax and Market Quality of the Taiwan Stock Index Futures” Journal of Futures Markets Vol. 26, No. 12 (2006)

hypothesis put forward by proponents of transaction taxes." <sup>24</sup>

**U.S. Derivatives Markets** – Tobin taxes have not been imposed by U.S. authorities on exchange traded futures markets to date. But the concept has been considered many times over the years. As a result, there is some body of research that does examine the possible effects of such an initiative.

Edwards (1992) examined "the various rationales to support a tax on securities markets to determine their applicability to futures markets and, second, by analyzing the likely effects of the tax on the competitiveness and efficiency of futures markets. In addition, the revenue-raising potential of a tax on futures transactions is evaluated. I conclude that a tax on futures markets will not achieve any important social objective and will not generate much revenue." <sup>25</sup>

Wang, Yau and Baptiste (1997) studied the relationship between trading volume and transaction costs in seven popular U.S. listed financial, agricultural and metals futures contracts. The authors utilized "a two-equation structural model with the use of a two-stage least-squares estimation procedure ... Empirical results confirm that trading volume and bid-ask spreads are jointly determined. Results also indicate that trading volume has a positive relationship with intraday price volatility and a negative relationship with bid-ask spreads, after controlling for other factors." <sup>26</sup> To the extent that transaction taxes represent a potential component of trading costs, these results suggest that transaction taxes would likely result in reduced liquidity and greater volatility.

Wang and Yau reached similar conclusions in 2000, studying four financial and metals futures ... "[r]esults from this study have important policy implications. Our results indicate that a transaction tax, which is analogous to a greater bid-ask spread, will reduce trading volume." <sup>27</sup>

An OECD study dating from 2002 examined FX derivatives markets including the currency options listed on the Philadelphia Stock Exchange. In particular, this study addressed the question "[d]o the potential benefits offset or balance the costs of such a tax in terms of economic efficiency? Potential benefits appear to be small and the costs could be large ... On the cost side, volatility could rise rather than fall, because of an indirect effect on liquidity, and ... [a market transaction tax] ... could hit particularly hard at those trades that enable low-cost hedging to take place. On balance, the downside risks would appear to outweigh the potential benefits." <sup>28</sup> In other words, the possible unintended consequences of transaction taxes could be quite harmful to the economy.

**Theoretical Reasoning** – The studies referenced above are grounded in an examination of particular markets, generally based on specific empirical research. However, some of the literature focuses on the question of transaction taxes on a theoretical level.

Pollin, Baker and Schaberg (2003) suggest that "security transaction excise taxes (STETs) ... [may be an effective] ... policy tool for promoting a more stable financial environment, specifically with respect to the U.S. economy. Contrary to a large recent critical literature, we show that a STET can be designed without creating large distortions between segments of the financial market. We also show that a modest STET for the U.S. - beginning with a 0.5 percent tax on equity trades and scaled appropriately for other financial instruments - would generate substantial new government revenues, on the order of \$100 billion per year." <sup>29</sup>

This study was theoretical in nature and not based upon any empirical data or any practical experience with transaction taxes in any particular venue. However, the authors document that of some 38 different countries that had imposed transaction taxes on securities or futures, 17 of those countries had subsequently reversed their decisions and either repealed or significantly reduced those taxes.

<sup>24</sup> Saporta, Victoria; Kan, Kamhon, "The Effects of Stamp Duty on the Level and Volatility of UK Equity Prices" Bank of England (1997)

<sup>25</sup> Edwards, Franklin R., "Taxing Transactions in Futures Markets: Objectives and Effects" Journal of Financial Services Research 75-91 (1992)

<sup>26</sup> Wang, George H.K.; Yau, Jot; Baptiste, Tony, "Trading Volume and Transaction Costs in Futures Markets" The Journal of Futures Markets Vol. 17, No. 7 (October 1997)

<sup>27</sup> Wang, George H.K.; Yau, Jot, "Trading Volume, Bid-Ask Spread, and Price Volatility in Futures Markets" The

Journal of Futures Markets Vol. 20, No. 10 (November 2000)

<sup>28</sup> "Exchange Market Volatility and Securities Transaction Taxes" OECD Economic Outlook, No. 71 (June 2002)

<sup>29</sup> Pollin, Robert; Baker, Dean; Schaberg, Marc, "Securities Transaction Taxes for U.S. Financial Markets" Eastern Economic Journal Eastern Economic Association, Vol. 29(4), (Fall 2003)

**Recent Renewed Interest** – Recent years have witnessed renewed interest in the concept. Of course, current proponents would apply Tobin taxes beyond the currency markets into most financial markets including equities, fixed income securities and derivatives.

This renewed interest is in large part motivated by the so-called subprime mortgage crisis. In many cases, the current proponents of the tax are motivated by an earnest wish to find a means of avoiding a repeat of such an episode. For example, Japanese Vice Minister of Finance Naoki Minezaki is on record as supporting a Tobin tax to curb market volatility that could threaten economic growth.<sup>30</sup>

Still others view such a tax as an opportunity to raise revenues for charitable causes or third world economic development. British comedian Richard Curtis has relabeled the Tobin Tax as the “Robin Hood Tax,” recommending a 0.05% levy on equity, FX and derivatives trading to be applied to relieve poverty and to promote environmental change.

The “Committee of Experts” reinforced these altruistic sentiments by suggesting that the “growth of the global economy has not been matched with effective means to levy global economic activity.” The Committee goes on to recommend a global currency transaction tax of 0.005% on interbank FX transactions, the receipts from which would be applied to pay for “global public goods.”<sup>31</sup>

In some cases, however, proponents may be motivated by a thinly veiled and vindictive desire to punish those who they would hold responsible for the crisis. “It’s akin to a gambling tax on socially negative activities,” according to Andrew Sheng, former Chairman of the Hong Kong Securities and Futures Commission.<sup>32</sup>

Others have cited fiscal concerns in an effort to compel the financial services industry to bear the cost of government bailouts. U.S. Congressman Peter DeFazio was quoted in December 2009 as suggesting that “American taxpayers bailed out Wall Street during a crisis brought on by reckless speculation in the financial markets ... This

[proposed Tobin tax legislation] ... will force Wall Street to do their part and put people displaced by that crisis back to work.”<sup>33</sup>

Thus, DeFazio introduced HR 4191 on December 3, 2009 in Congress. This bill would have introduced a “securities transaction tax ... applied to stock transactions (1/4 of 1 percent (0.25%)), futures (0.02%), swaps (0.02%), credit default swaps (0.02%), and options (at the rate of the underlying asset).” The objective was to raise \$150 billion in annual revenues. DeFazio proposed that half the revenues should be applied against the growing Federal deficit while the other half of the revenues should be deposited in a “Job Creation Reserve to fund the creation of good paying jobs and put Americans back to work rebuilding our Nation.”<sup>34</sup>

HR 4191 was eventually supplanted with the passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173) which was signed into law by President Obama on July 21, 2010. However, it remains unclear whether the issue might be revived during subsequent Congressional sessions.

On March 10, 2010, the European Parliament approved a resolution to consider a global financial transaction tax. The resolution urged that the European Union “agree on a common position in the international framework of G20 meetings as regards the options as to how the financial sector should make a fair and substantial contribution towards paying for any burden which it has caused to the real economy or which is associated with government interventions to stabilize the banking system.”<sup>35</sup>

By October 7, 2010, the European Commission reported to the European Parliament a recommendation to “launch a comprehensive impact assessment, which will further examine each of these ... [transaction tax] ... options, in order to be in a position to make appropriate proposals on policy actions by summer 2011.”<sup>36</sup>

<sup>30</sup> “FT’s Lex’s McLannahan on Potential Tobin Tax in Japan” Bloomberg (February 17, 2010).

<sup>31</sup> Report of the Committee of Experts to the Taskforce on International Financial Transactions and Development “Globalizing Solidarity: The Case for Financial Levies” (October 22, 2009).

<sup>32</sup> “Taxing Wall Street Today Wins Support for Keynes Idea of 1936” Bloomberg (November 30, 2009).

<sup>33</sup> Pope, C. “DeFazio Calls for Tax on Financial Transactions but Critics Abound” The Oregonian (December 3, 2009).

<sup>34</sup> “Text of H.R. 4191: Let Wall Street Pay for the Restoration of Main Street Act of 2009” [www.govtrack.us](http://www.govtrack.us) (December 3, 2009).

<sup>35</sup> “Euro Parliament Approves Resolution to Consider Global Financial Transaction Tax” Alston & Byrd (March 10, 2010).

<sup>36</sup> “Communication for the Commission to the European Parliament, the Council, the European Economic and

# Impact of Tobin Taxes

October 22, 2010

Page 8 of 9



However, it is significant that the Commission suggests that any such taxes would be passed through to ordinary investors and to the general population and would likely increase price volatility. In particular, "while the value to the economy of high-speed trading is questionable, the extent to which this activity was a main driver of negative externalities in the crisis has still to be studied."<sup>37</sup>

While the Commission believes that taxation of both exchange-traded and over-the-counter derivatives is technically feasible, it further believes that the financial sector excels circumventing taxation. Thus, it appears that Europeans are likely to adopt a more contemplative and less aggressive approach to the question of Tobin taxes.

**Conclusion** – Many diverse opinions have been expressed with respect to the concept of a Tobin or financial transaction tax dating back to the time of John Maynard Keynes. Much of the work on such a tax has necessarily been theoretical in nature as there are a limited number of practical applications of such a levy to study.

However limited in number, studies regarding the practical experience with Tobin or transaction taxes in a number of jurisdictions almost unanimously suggests that taxes tend to ... (i) increase volatility; (ii) detract from market liquidity and the price discovery function; and, (iii) results in reduced rather than increased tax receipts. A further result of such taxes is the expatriation of the marketplace to more liberal tax jurisdictions noting the practical impossibility of applying the tax on a uniform basis.

Recent events have caused the issue to resurface as the subject of considerable interest and debate. At least in the near-term, however, it appears unlikely that either the European Union or the United States will adopt any form of Tobin taxes. The European Commission report detailed above raises too many questions regarding the impact of such a tax. The DeFazio bill was superseded by passage of the Dodd-Frank legislation and the Democrats are facing a major challenge in the forthcoming mid-term elections.

Further, any major jurisdiction intent on enacting a Tobin tax would likely require a uniform, coordinated tax to be applied on an international basis to avoid

expatriation of financial activities. Such coordination in this regard, particularly where the proceeds are to be applied to securing "global public goods" is likely to be considered far too utopian to become a realistic possibility.

Thus, barring any unforeseen financial calamities, we anticipate that the debate over Tobin taxes will slowly become relegated to the back pages over coming months. Still, this is an issue which we fully expect to reemerge periodically in coming years, just as it has periodically reemerged since 1936 when originally proposed by Keynes. We must be prepared to address the issue as it periodically resurfaces and hope that the current piece contributes to such an understanding of, or at least serves to frame, the relevant issues.

*For more information, please contact ...*

Steve Youngren, Associate Director  
Research & Product Development  
312-930-4583, [steve.youngren@cmegroup.com](mailto:steve.youngren@cmegroup.com)

John W. Labuszewski, Managing Director  
Research & Product Development  
312-466-7469, [jlab@cmegroup.com](mailto:jlab@cmegroup.com)

---

Social Committee and the Committee of the Regions, "Taxation of the Financial Sector" European Commission, Brussels (October 7, 2010).

<sup>37</sup> *Ibid.*

## "Tobin Tax" Market Impact

Study	Market(s) Examined	Impact on					Other
		Volatility	Liquidity	Price Discovery	Tax Revenue		
Campbell & Froot (1993)	Swedish stocks and bonds		↓		↓	Significant expatriation of trading activity	
Chou & Lee (2002)	Taiwan futures		↓	↓		Market migrated to Singapore	
Chou and Wang (2006)	Taiwan futures	↑	↓	↓	↓	Market migrated to Singapore	
Chung, Liu, Wu, Yang (2003)	Taiwan futures	↑	↓	↓	↓	Market migrated to Singapore	
Edwards (1993)	U.S. futures		↓		↓	Market migrated	
Feldstein (1988)	NY Eurobond					Market migrated to Europe	
Greene (1969)	NY Eurobond					Market migrated to Europe	
Habermeier & Kirilenko (2003)	Swedish stocks	↑	↓			Market migrated to London	
Hu (1998)	Japan, Hong Kong, Korea, Taiwan	Inconclusive	Inconclusive				
Lui (2007)	Japanese stocks			↓			
OECD Study	U.S. FX Options	↑					
Pollin, Baker & Schaberg (2003)	Theoretical				↑		
Saporta and Kan (1997)	UK stocks	No effect					
Shvedov (2004)	Japanese stocks				Temporary success	Market migrated away from Japan, other unintended results	
Umlauf (1993)	Swedish stocks	↑	↓	↓		Market migrated to London	
Wang & Yau (2000)	U.S. futures	↑	↓				
Wang, Yau and Baptiste (1997)	U.S. futures	↑	↓				

**Copyright 2010 CME Group All Rights Reserved.** CME Group™, the Globe Logo, Globex® and CME® are trademarks of Chicago Mercantile Exchange Inc. CBOT® is the trademark of the Board of Trade of the City of Chicago. NYMEX is trademark of New York Mercantile Exchange, Inc. The information herein is taken from sources believed to be reliable. However, it is intended for purposes of information and education only and is not guaranteed by CME Group Inc. or any of its subsidiaries as to accuracy, completeness, nor any trading result and does not constitute trading advice or constitute a solicitation of the purchase or sale of any futures or options.

Unless otherwise indicated, references to CME Group products include references to exchange-traded products on one of its regulated exchanges (CME, CBOT, NYMEX, COMEX). Products listed in these exchanges are subject to the rules and regulations of the particular exchange and the applicable rulebook should be consulted.