



The Robin Hood Tax Won't Do The Trick

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The Robin Hood Tax won't do the trick. We need a Financial Activities Tax...

By John Grahl and Photis Lysandrou

In 2011, the European Commission proposed a Financial Transactions Tax (FTT) to raise revenue from the financial sectors in EU countries following the financial crisis. To date however, only eleven EU states have agreed to implement such a tax. While they broadly agree with the objectives behind the FTT, John Grahl and Photis Lysandrou argue that the approach adopted toward the financial sector is too simplistic because it relies on the idea that all short term trading is economically dysfunctional. They suggest that a lot of this trading is not speculative, but represents necessary portfolio rebalancing by institutions – pension funds, insurance companies, unit trusts and so on – who would be unable to manage the assets of their customers effectively if they could not trade.

By applying an indiscriminate tax to all forms of trading, the FTT could therefore create serious unintended consequences and fail to meet its intended goals. They recognise that there is also a lot of high frequency trading which is dysfunctional (amounting to front-running and exploiting the trades of institutional investors) but argue that separate measures should be taken to deal with this. A tax on the total income of the sector (a “financial activities tax” or FAT) would raise more money with fewer unintended effects.

Eleven member states of the European Union – including France and Germany – have agreed to introduce a Financial Transactions Tax (FTT), to be levied whenever financial assets, such as shares, are traded. Such a tax is a long-standing demand of the left. It is seen as a way of reducing financial speculation, of exacting revenue from the banks and other financial corporations that were responsible for the 2008 financial crisis, and of cutting down to size an overblown financial sector. We support all three of these objectives. However in a [recent article](#) we criticise the FTT from the perspective that its approach to the financial sector is simplistic.

The financial sector is a very powerful and risk-taking interest group, or set of interest groups. Its conduct regularly, almost routinely, involves speculation and deception. The failure to establish effective regulation of the sector very recently provoked the most severe economic crisis since the 1930s.

Finance is also a function of the global economy and an indispensable one. Free market orthodoxy teaches that the market economy is self-equilibrating. However, if this were the case, money and finance would not be essential features of capitalism, but lubricants of a mechanism that would function less efficiently without them. Most critical economists, from whatever school of thought, take a contrary view. They say that markets do not clear, and the price and quantity adjustments that are supposed to make them do so can often widen rather than narrow imbalances. They argue that not only does disequilibrium prevail in the normal workings of the capitalist economy, but that economic progress and innovation under capitalist conditions require that imbalances are multiplied and aggravated.

If this is the case then finance is necessary for the very existence of the capitalist economy. If those with deficits – households, corporations, and governments – were not continuously refinanced by those with surplus financial resources, a breakdown of market relations would follow immediately. In reality, the price changes so celebrated by free market theorists are not the key to adjustment that they are claimed to be; rather, adjustments are forced on indebted agents as a condition of refinance or in consequence of liquidation. Actors with a surplus of financial resources may choose to adjust, but those with debts are compelled to do so and this is the source of one of the great asymmetries that critical economists see in the functioning of the capitalist economy. Thus we approach the FTT issue with a perspective on finance that both recognises it as an essential function and as a dangerous grouping of interests. Our concern with the FTT is not at all that it challenged these interests, but that it might seriously impair financial function.

Here it is necessary to note that the FTT proposal has been very much weakened over time, partly under pressure from the financial sector and partly in response to technical objections. It was never intended to tax primary security markets, that is, the initial sale of securities by the company or government that requires funds. However, in the form originally put forward by the European Commission, the FTT was going to be applied to all trading in all secondary markets, where the initial purchasers of

shares or bonds sell them in order to exit from their investment. This was the “triple-A” approach: to tax all markets, all instruments, and all actors. It was inspired by the view that this would discourage short term trading because the tax in this form would be heaviest on the dealers and investors who traded most frequently, while those who were prepared to buy securities and hold them over the long term would largely escape. However, portfolio balancing, which requires continuous algorithmic trading, is needed to maintain the representative nature of portfolios defined in terms of benchmarking to specified indexes. This trend has been driven by structural changes in the asset management industry intended to realise more accountable and efficient intermediation.

An effective measure against high-frequency traders could be based on the fact that they assume the role of market makers who quote both bids and offer prices for the securities they are interested in. These quotes are very rapidly taken down when they threaten to disadvantage the traders who post them. To suppress the whole business it might well suffice to require the quoted prices to be maintained for a somewhat longer period of time – a few seconds would probably be more than enough.

A second case is the [Repurchasing Agreement \(Repo\) market](#). In economic terms this does not involve security trading at all, it is simply a credit market mostly used by banks lending to and borrowing from each other. The securities involved are not being traded but are being used as collateral for these loans. In legal terms, however, a repo deal involves two trades: the borrower sells the securities to the lender and then buys them back at what is basically the same price. This sale and repurchase form is adopted to establish legal clarity – it makes it much easier for the lender to hold on to the collateral in the event of a default by the borrower.

To tax these credits as though they were security trades would be illogical, and would seriously impair the interbank credit market. That market is, in general, stable and is very important because central banks normally implement their interest rate policies by operating on the interbank market. Margins are normally very narrow on the repo market and even a small tax could seriously impair its function.

Moreover, such a tax could have severe unintended consequences. Since it was not proposed to tax foreign exchange (FX) trading, European banks would move from using repos, where the collateral mostly took the form of EU government bonds, to using FX swaps where the collateral was foreign currency – in practice US dollars – and the EU money market would become even more dependent on financial conditions in the US.

It is true both that repo markets, like other credit markets, may have become [too liquid](#) in the run-up to the crisis of 2007-8 and that the interbank markets in Europe were seriously damaged by banks’ difficulties during the crisis. In neither case, however, was the problem one of security trading: in the first case it is an issue of monetary policy, in the second, one of bank recapitalisation and the purging of bad

loans. Bank credits and the issue of marketable securities are often seen as alternative types of finance, it is strange to tax the latter to deal with the problems of the former.

We would argue that an indiscriminate approach to all trading, or to all transactions that could be regarded as such, is both illogical and likely to be economically damaging. It is not clear that discouraging trading would reduce volatility; in fact the financial markets with the most intense trading also tend to be the most stable. As for the revenue to be raised by the FTT, official estimates have been drastically reduced. Meanwhile the scope of the tax has been cut back. “Triple-A” has been abandoned and the tax is now intended only to apply to equity trades and trades in equity derivatives. Not only are repos to be exempt but also (somewhat illogically), genuine trades in government bonds. There will also be practical difficulties stemming from the fact that only eleven countries are involved and that resistance from the financial sector has hardened.

Our argument, however, does not rely on that resistance or on the wish of many governments to opt out of the tax. Such problems would arise with any attempt to tax or otherwise restrict the financial sector, even if the tax were better designed. We suggest that a simple tax on financial activities, essentially a tax on the total income of the sector (a FAT), would raise more money with fewer unintended effects. Finance is a complex matter, but it is necessary to tackle that complexity if one wishes to pursue the very important objective of establishing social control over financial systems. We feel that the failure to achieve any such control with the FTT gives a clear lesson in how not to implement reform.

For a longer discussion of this topic, see the authors' 2013 [article](#) in the Journal of Common Market Studies

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