# TOBIN TAX: ARGUMENTS AND CURRENT DERIVATIVE STUDIES

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***Abstract:***
*Tobin Tax and its derivative applications have started to be discussed again in many platforms as the issue regarding taxation of short-term capital movements has become an agenda among international communities such as European Union (EU) and G20 since the beginning of 2000s. In this study, Tobin Tax, which is the first significant step towards taxation of foreign currency transactions, has been discussed theoretically and considering its possible effects on application. Also, in this context, the initiatives of countries such as USA, Belgium, France and Austria regarding international implementation of Tobin Tax and its derivatives are being evaluated. The intended use of the taxes, determination of transactions exempt from tax and international cooperation in the implementation of taxation are possible problems that can be faced regarding Tobin Tax. In this study the conclusion, which the effects of Tobin Tax in developing and developed countries will be different but imposing such tax regarding cyclic balance of the world economy will be a positive improvement, has been reached.*

***Key words:*** *Tobin tax, short-term capital movements, exchange rate, taxation*

## 1. Introduction

It is known that the idea of taxation of exchange rate was mainly created by the Nobel winning economist James Tobin (1918-2002). In his book named “A Proposal for International Monetary Reform” J. Tobin has emphasized that the primary concern did not result from whether the exchange rate system was floating or fixed; but from mobility of private financial capital; and has suggested Tobin Tax against the source of the problem (Tobin, 1978: 153). Tobin suggested imposing a tax on foreign exchange spot transactions first in 1972 in order to minimize fluctuations in exchange rates as well as to aid macroeconomic performances of countries and to contribute to international development with the income obtained by this tax (Raffer, 1998: 529).
Suggestion of Tobin is implementation of an international and uniform tax in spot exchanges of all currencies in proportion with the magnitude of transactions (Tobin, 1978: 155). According to Tobin, the aim of this tax is not to decelerate financial stability but to increase efficiency of monetary and fiscal policies. Particularly monetary policies are under the influence of capital movements in terms of exchange rates and balance of trade (Dodd, 2003: 174).

Although the idea of taxation of exchange rate was named after J. Tobin, it goes back to J. M. Keynes's book named "The General Theory of Employment, Interest and Money" published in 1936 in which Keynes criticized manipulations of the speculators in financial markets. Keynes has suggested implementation of transfer tax in order to limit speculative capital movements whereas Tobin has transferred Keynes's suggestion to international level (Palley, 2003: 6). Keynes has emphasized that the transaction tax to be imposed in financial markets played a significant role in restraining short-term speculations and promoting long-term investments. According to Keynes, any tax to be implemented in the stock market shall affect short-term buying-selling profit gainers in accordance with its purpose; yet shall not affect investors (Yıldız, 2005: 5).

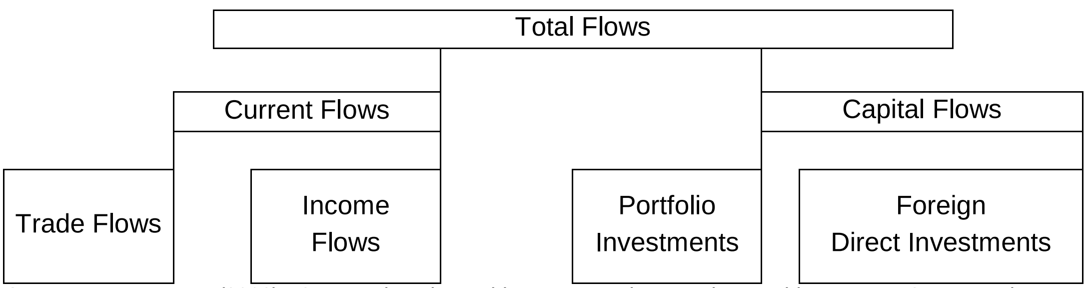
## 2. Objective and Scope

Exchange transactions tax or Tobin tax, with its recognized name, has two significant objectives. The first one is to decelerate and thereby reduce speculative capital movements of variable exchanges; and the second one is to strengthen national monetary and fiscal policies which are restricted by floating exchange rates and free capital movements (Hinman, 2003: 157).

With the implementation of Tobin tax, profitability and therefore mobility of speculative exchange transactions shall decrease leading to a more stabilized international financial system and generating a potential income (Şen et al., 2004: 94). Besides, Tobin Tax aims protecting monetary independence of governments by lowering the speed of foreign exchange flows and minimizing the loss created by conversion of currencies (Arıkan and Yurtsever, 2004: 128).

Tobin Tax can be implemented in compliance with its objective only if accepted with the consensus of governments. Otherwise, there shall be a reduction in financial transactions of the countries which decide to implement the Tobin Tax. Besides, speculative movements on domestic currency of a country which carries out current financial transactions over other countries shall still continue (Yılmaz, 2002: 5). The total flows generated by international cash and capital flows is located in Table 1.

**Table 1: International Total Flows**




**Source:** Zee, H. H. (2003). Overcoming the Tobin Tax's Implementation Problems: Tax Cross-Border Capital Flows, not Currency Exchanges. Conference on Debating the Tobin Tax: New Rules for Global Finance, p.111.

Among the total flows indicated in Table 1, the proportion considered under the scope of Tobin Tax is the capital flows and the portfolio investments in particular. Tobin Tax might be implemented in all special flows; yet relevant portion centers on capital flows since current flow and sub groups are not related to capital movements. (Zee, 2003: 111).

Tobin Tax has got a simple design. It involves implementation of a low rate tax during conversion of one currency into another. When J. Tobin first brought forward his suggestion in early 1970s, he had indicated that the rate of this tax, to be collected ad-valorem (according to value) over spot exchange transactions, should be between %0.1 - 0.5 (Tobin, 1999: 49).

It is possible to explain the extent of the effect of Tobin Tax on short-term capital movements with a numeric example. For example, a speculator supposes that USD shall gain value against Euro. He is going to sell 1 million Euro and buy 1,1 million USD for one week. If USD parity increases, he is going to sell 1,1 million USD for 1,1 million Euro and gain a net profit of %10. With implementation of Tobin Tax, the speculator is going to pay %0.5 (5,000 Euro) when buying USD and 5,000 USD (5,500 Euro) when selling Euro which makes a 10,500 Euro tax in total. Therefore, total paid tax shall constitute %10.5 of the total gain. In this example, tax is paid by the parity change. Tobin Tax can also be implemented if foreign exchange purchase-sales transaction is performed when parity is fixed. In another example the speculator shall pay 5,000 Euro when buying and 5,100 Euro when selling (tax rate %1); which will make payment of a 100 Euro tax (Patterson and Galliano, 1999).

The argument regarding the authority to collect the Tobin Tax, the prevailing standpoint is that it shall be collected in a central fund under the control of IMF or the World Bank. Another opinion is that tax incomes shall be collected by central banks of governments at local level, and these incomes shall be transferred to international foundations (Kıldiş, 2003: 198).

A decision has not been made on where and with which purpose the income to be obtained by Tobin tax shall be used. J. Tobin has stated in his suggestion that Tobin Tax revenue could be used for financing expenses of United Nations. J. Tobin's suggestion in 1970s as to where to use the tax incomes is to transmit these incomes to third world countries as foreign assistance (Felix, 1995: 58). According to J. Frankel (1996: 34), potential Tobin Tax incomes can be used for disaster assistance, peace force activities, nuclear security and mostly for social projects.

Other transactions except for Tobin Tax are also emphasized in Tobin Tax suggestion. In Tobin's suggestion, the transactions executed in monetary union regions are considered to be free of tax. This exception can be applied not only for European Union (EU) but also for other country currencies indexing their money to another currency. Besides, according to some emerging ideas, small amount of exchange transactions arising out of commercial activities of tourists and the real sector should be exempt from the Tobin Tax. In addition to these, there are some ideas suggesting that interbank exchange transactions should also be exempt from tax. In this respect, J. Tobin has emphasized that the tax should particularly be implemented on banking business. Therefore, exemption of interbank transactions does not comply with the objective of the tax (Yıldız, 2005: 9).

J. Tobin has suggested that the tax should only be implemented on spot exchange transactions. Yet, execution of short-term speculative transactions can be maintained by financial tools which are exempt from tax since they involve only spot exchange transactions. Such transactions might lead to volatility; therefore they should be considered under the scope of the tax (Güzel, 2000: 105). Besides, Tobin Tax shall only be implemented on spot transactions; so derivatives shall emerge for being exempt from the tax. Therefore, the scope of Tobin Tax should be extended considering future derivatives (Yıldız, 2005: 10). Besides, the question as to which derivative transactions shall be exempt from Tobin Tax is still not answered.

## 3. Related Arguments

Arguments related to Tobin Tax are classified in two groups. According to the views in favor of Tobin Tax, Tobin Tax is useful and its implementation leads to positive results. According to the views against Tobin Tax, Tobin Tax is a problematic tax for implementation on which a consensus is not reached.

According to defenders of the Tobin Tax, Tobin Tax is a practicable tax which might assist reducing financial instability. This supported idea might be embraced in three significant factors according to T. I. Palley (2003). The first of these is that Tobin Tax has a significant place as part of the reform in terms of financial structure with regard to prevention of financial crisis. The second significant factor is that Tobin Tax is a part of taxes related to financial market transactions and Tobin Tax also supports other Financial Transaction Taxes (FTT). The third factor is that Tobin Tax might provide high tax income with its purpose to develop international financial stability. According to Palley, Tobin Tax, with all these three factors, is applicable both to maintain financial stability and to gain high income in terms of economy.

I. Grabel (2003: 94), in parallel with Palley's ideas, has interpreted Tobin Tax as a potential power to increase government revenues. For example, it is found that a low rate Tobin Tax which shall be implemented worldwide might provide an annual income of 16-35 billion USD (based on 2001 exchange market data). K. Raffer (1998: 533), has emphasized that Tobin Tax should reduce appeal of interest arbitrage and small exchange rate changes.

Many Tobin tax supporters suggest that the income obtained by the implemented tax should be used in social responsibility projects including supporting economic development projects, United Nations projects or environmental protection projects (Grabel, 2003: 94). According to a study carried out by United Nations, in case of implementation of Tobin Tax at a rate of 0.05%, an income of about 150 billion USD might be obtained (Angelis, 2000: 189).

In below given Table 2, effective Tobin Tax rates are given changing according to frequency of exchange transactions with implementations of Tobin Tax at a rate of 0.01-1%.

**Table 2 Annual Effective Tobin Tax Rates According to Frequency of Exchange Transactions**

| Nominal Rates of Tobin Tax | Effective Rates of Tobin Tax (Annual, %) | | | | |
|---|---|---|---|---|---|
| % | 1 Week | 1 Month | 3 Months | 1 Year | 10 Years |
| 0.01 | 1.04 | 0.24 | 0.08 | 0.02 | 0.002 |
| 0.05 | 5.2 | 1.2 | 0.4 | 0.1 | 0.01 |
| 0.1 | 10.4 | 2.4 | 0.8 | 0.2 | 0.02 |
| 0.15 | 15.6 | 3.6 | 1.2 | 0.3 | 0.03 |
| 0.2 | 20.8 | 4.8 | 1.6 | 0.4 | 0.04 |
| 0.025 | 26.0 | 6.0 | 2.0 | 0.5 | 0.05 |
| 0.5 | 52.0 | 12.0 | 4.0 | 1.0 | 0.1 |
| 1 | 104 | 24 | 8 | 2 | 0.2 |

**Source:** Patterson, B. & Galliano, M. (1999), The Feasibility of an International "Tobin Tax. European Parliament, Economic Affairs Series.

It can be seen in Table 2 that Tobin Tax ratio increases as tax frequency increases. The Tobin Tax rate of 0.1% becomes 10.4% when exchange transactions are executed once a week; becomes 2.4% when exchange transactions are executed once a month; becomes 0.8% when exchange transactions are executed once in every three months; becomes 0.2% when exchange transactions are executed once a year; and becomes 0.02% when exchange transactions are executed once in every ten years. The rates become lower depending on frequency of execution. This means that Tobin Tax increases the cost of short-term exchange transactions; but it does not have much influence on the cost of long-term exchange transactions.

R. Schmidt (2001: 200) has listed the advantages of Tobin Tax as given below;

- Generates income growth and helps increase of official exchange reserves in crisis periods;
- If implemented as uniform, brings lower cost, requires less need for an administrative structure and control and constitutes a more clear tax;
- Might be tuned according to economic conjuncture by being implemented at higher rates in crisis periods; and at lower rates in periods except crisis periods.

Contrary to the ones who argue that the Tobin Tax is effective on speculative short-term capital movements; the ones who are against the Tobin Tax speculative short-term capital movements cannot be prevented by taxation but by effectively implemented macroeconomic policies. According to another critique against Tobin Tax, related tax might restrict speculative capital movements but also might prevent capital inflow (Arıkan and Yurtsever, 2004: 130–131). According to another critique, if the rate of the tax to be implemented is low, speculators cannot be stopped; if it is high financial flows shall remain within the country restraining international movements (Sarfati, 2003: 87).

An important part of the critiques made against the Tobin Tax involve possible problems which might be experienced in its implementation. C. Yılmaz (2002: 2) has listed possible problems which might be experienced in its implementation as given below;

- Implementation of Tobin Tax requires cooperation of significant financial centers. Otherwise, majority of exchange market transactions shall shift towards places free of tax. Yet, providing an international cooperation with a Tobin Tax to be implemented worldwide is rather difficult.
- The tax shall lead to a limited decrease in transaction and liquidity volume; yet it shall constitute a huge stationery cost; and these all shall increase implementation difficulties.
- The question as to which transactions shall be exempt from the tax, which transactions shall be subject to taxation, and what the tax base shall be remains unresolved.
- Its implementation is projected to reduce price fluctuations; but it is also emphasized that it shall increase them.

First of other problems related to implementation of Tobin Tax is the difficulty to differentiate speculative transactions from monetary transactions obtained from commercial activities in international exchange markets (Şen and et al., 2004: 106). It shall not be possible to implement the Tobin Tax without performing this differentiation accordingly. The second problem is that Tobin Tax might cause tax pyramiding after its implementation. One government might collect taxes over speculative capital transactions under the scope of their own laws; collection of Tobin Tax over the same transactions shall mean twice taxation. This situation shall lead to exceeding of tax rate in other words tax pyramiding. Besides, the facts that a consensus has not been made on where and with which purpose the income to be obtained by Tobin tax shall be used; and how it shall be shared among countries can be mentioned as other critiques (Şen et al., 2004: 103-106).

## 4. Derivative Studies

The financial crisis which affected Mexico in 1997, Eastern Asia in 1997-98, Brazil in 1999, Turkey in 2000, and lastly in Turkey in 2007; have kept the need for Tobin Tax on the agenda. Accordingly, in many countries, particularly USA and European countries, Tobin Tax and derivative implementations based on Tobin Tax (FTT, STT, Spahn Tax, Robin Hood Tax, etc.) are intensively argues in government assemblies and international organizations (European Parliament, United Nations, etc.).

USA has been implementing taxes like the Tobin Tax since 1980s in order to reduce speculative capital movements and increase effectiveness of financial markets.

In 1990s, 0.5% taxation for all financial tools including stock shares, bills of exchange, debt securities etc. owned by all domestic and foreign investors was brought forward under the name Capital Stock Transaction Tax (STT); yet it was rejected in the USA Congress (Schwert and Seguin, 1993: 28).

P. B. Spahn (1996) has suggested Spahn Tax as an alternative to the Tobin Tax. Spahn, has emphasized that the Tobin Tax would not be effective, this tax would ruin the operation of international finance markets and lead to liquidity problems. The tax as suggested by himself consists of two ties. First, a small amount of tax to be collected from all normal transactions, and secondly an additional exchange tax to be collected over very short-term transactions which might create speculative fluctuations. Thereby, free motion of the exchange rates shall be allowed in a certain band. Going beyond the band shall be subject to taxation. This shall allow control of exchange rates within the aimed band without intervention of the Central Bank of without reducing international reserves.

In 2004, Belgium Federal Parliament has approved the Spahn Tax as a law draft. Belgium, in this respect, shall introduce the Spahn Tax, which is a derivative of the Tobin Tax, to Eurozone countries (the 18 EU member country using Euro as currency). The tax proposal of Belgium shall become effective upon approval of all members of European Union Economic and Monetary Union (EMU); and for some articles of the law, upon approval of the European Commission (Quaghebeur, 2004: 729).

Canada and Finland are the leading countries which have decided to support the Tobin Tax in 1999. The Labor Party in England has made a motion for implementation of the Tobin Tax with 6 parties including liberal democrats and some conservative parties and 147 signatures (Walia, 2004: 29). In Brazil, 100 parliament members have established a formation to support the Tobin Tax. In France, President L. Jospin has suggested to implement a 0.1% Tobin Tax in 1995 (Patterson and Galliano, 1999); French National Assembly has voted for the Tobin Tax. Yet France’s decision does not have a meaning unless all EU members accept the Tobin Tax (Walia, 2004: 29). In 2005 W. Schüssel, former President of Austria, has made a call to EU stating that the Tobin Tax could make financial markets more independent and stable; yet could not receive an affirmative response (Patomaki, 2009: 2).

Following the financial crisis originating from the banking sector in 2007, the banks increased their political pressure on the governments for implementation of the Robin Hood Tax[1], which is a tax like the Tobin Tax, in 2010 in order to return to their financial status before the crisis. Implementation of an international tax in the banking sector has been researched by the Internationel Money Fund (IMF); this argument has been brought to the G20 Summit (Seely, 2014: 1).

In 2010, before the G20 Summit in Toronto, President of the EU Council Herman Van Rompuy and President of the EU Commission Jose Manuel Barroso together wrote a

[1]Robin Hood Tax was first suggested in 2001 by foundations named “War and Want” and “The New Economics Foundation” in the UK. This suggestion involves implementation of a small rate tax (between 0.005-0.5%) on all currency transactions in order to maintain financial stability (Sanger, 2013: 192).

letter to underline the need for constituting and developing a global financial transactions tax (Reuters, 2010). The tax as proposed by EU Council and Commission as the Financial Transactions Tax[1] was based on the Tobin Tax; yet its scope was extended.

FTT, covers a broader tax base; and short and long-term transactions together. Besides, it projects a tax rate of 0.1%; over bills of exchange and stock shares; and of 0.01% over derivative transactions (EU Commission, 2011: 20). France, which is among G20 countries, has announced their positive approach on this derivative proposal in 2011; has gained support of some countries; yet could not implement the mentioned tax due to some problems related to Eurozone (Seely, 2014: 7-8). In October 2012, 11 EU countries[2] have decided to implement the FTT Tax, similar to the Tobin Tax (Seely, 2014: 1).

## 5. Conclusion

The scope of this study draws an outline of the Tobin Tax including pros and cons and alternatives. Particularly the potential problems which might be experienced with reference to the scope and implementation of the Tobin Tax, presents two different views. The Tobin Tax, on which not any consensus has been obtained, has been discussed since 1970s when it was first suggested.

In order to implement the Tobin Tax or its derivatives, all countries must approve of the tax and implement it in the same manner. Otherwise, economic problems might arise for the countries implementing the tax, and speculative capital movements might not be prevented. Yet, not any consensus has been obtained among countries regarding implementation of the Tobin Tax or its derivatives.

In order to respond to the questions related to the Tobin Tax, potential implementation problems have to be resolved reasonably. The Tobin Tax, which might be implemented upon resolution of potential problems, might be able to protect national economies against negative impacts of short-term capital movements. Besides, thereby financial crisis might be decreased and national economies might increase their investment with long-term capital movements instead of short-term capital movements to obtain economic growth.

In developing countries, where short-term capital movements are intensively experienced, Tobin Tax and its derivative have critical importance. If these taxes, which are again on the agenda of EU member countries and G20 counties since 2010, start being implemented, it shall reduce hot cash inflow in countries, where short-term capital movement are intensively experienced. Yet, on the other hand, by governments might obtain income by implementation of a regressive tax decreasing by conversion of short-term hot cash into long-term and by transition from short-term to long-term; and

[1] Whereas Tobin Tax suggests implementation of taxes on exchange transactions in spot markets; Financial Transactions Tax suggests implementation of tax not only on spot markets but also on transactions on all exchange markets (forward, futures and options) (McCulloch and Pacillo, 2011: 4).

[2] Belgium, Germany, Greece, France, Austria, Portugal, Slovenia, Estonia, Spain, Italy and Slovakia (Seely, 2014: 1).

such income might be used for social responsibility projects. Besides, if a consensus is obtained among EU member countries or G20 countries, developing countries must also be included in this tax decision.

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