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A General Financial Transaction Tax

Die Finanztransaktionssteuer – pro und contra

Stephan Schulmeister

IMF meeting on Financial Sector Taxation in Washington on January 28, 2010 & Disput im Bundesministerium für Finanzen am 23. Februar 2010

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- Dynamic epicenter of the current crisis:
 - Devaluation process of stock, housing and commodity wealth
 - Coincidence of three "bear markets"
 - "Built up" during the preceding "bull markets" >
 - Long swings in asset prices >
 - Outcome of "trading as usual"
 - Overshooting rather the rule than the exception

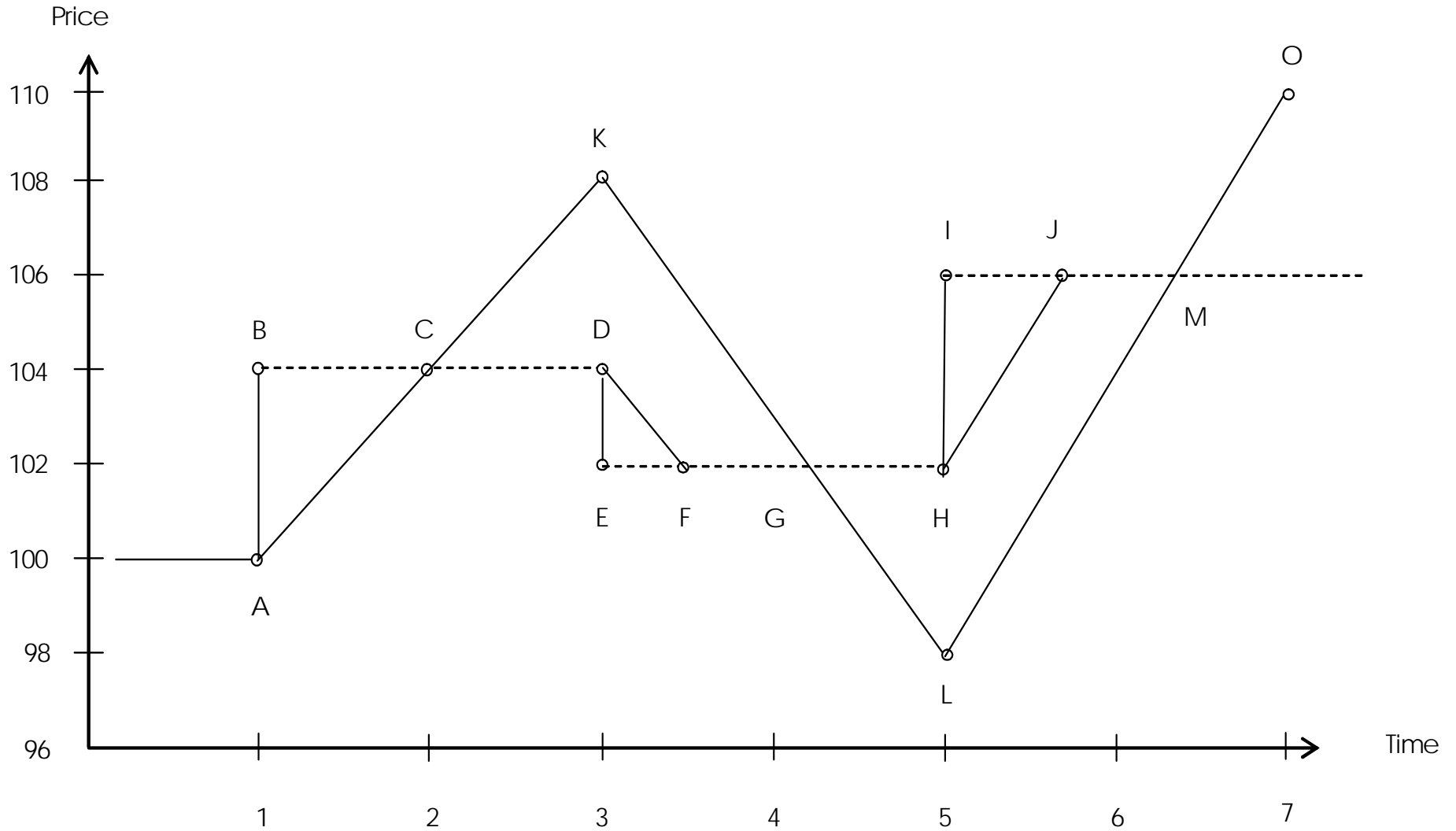
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- “Fundamentalist hypothesis” and “bull-bear-hypothesis”
 - Pattern of asset price dynamics
 - Technical trading, trending, overshooting
 - Expansion of financial transactions
 - Concept of a general transaction tax
 - Estimates of FTT revenues

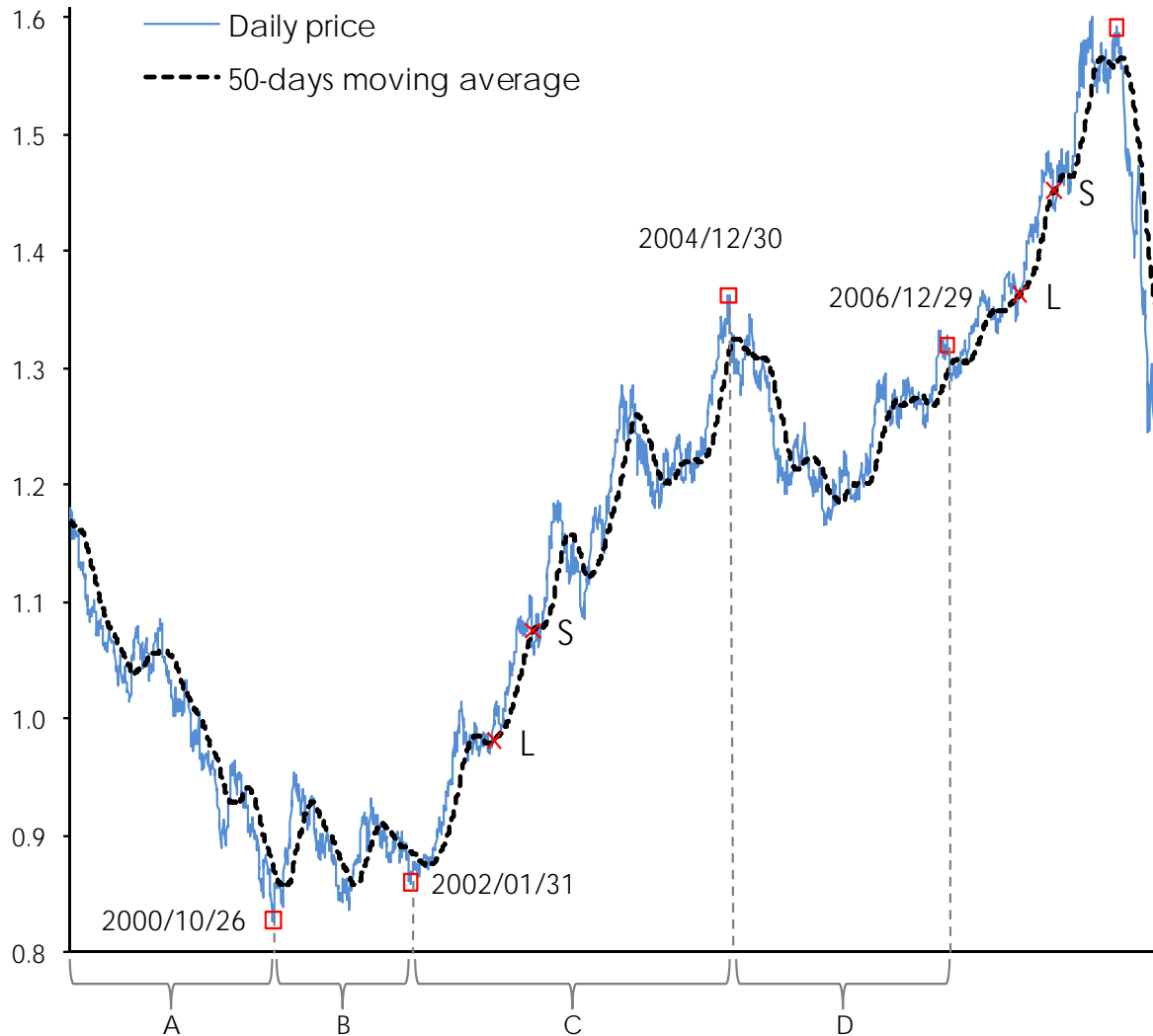
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- Theoretical benchmark model ("world 0"):
 - Frictionless market
 - Perfect knowledge
 - No transaction costs
 - Fundamentalist model ("world I"):
 - Transaction costs
 - Actors are fully rational
 - Do not know the expectations of other actors >
 - Gradual price discovery process

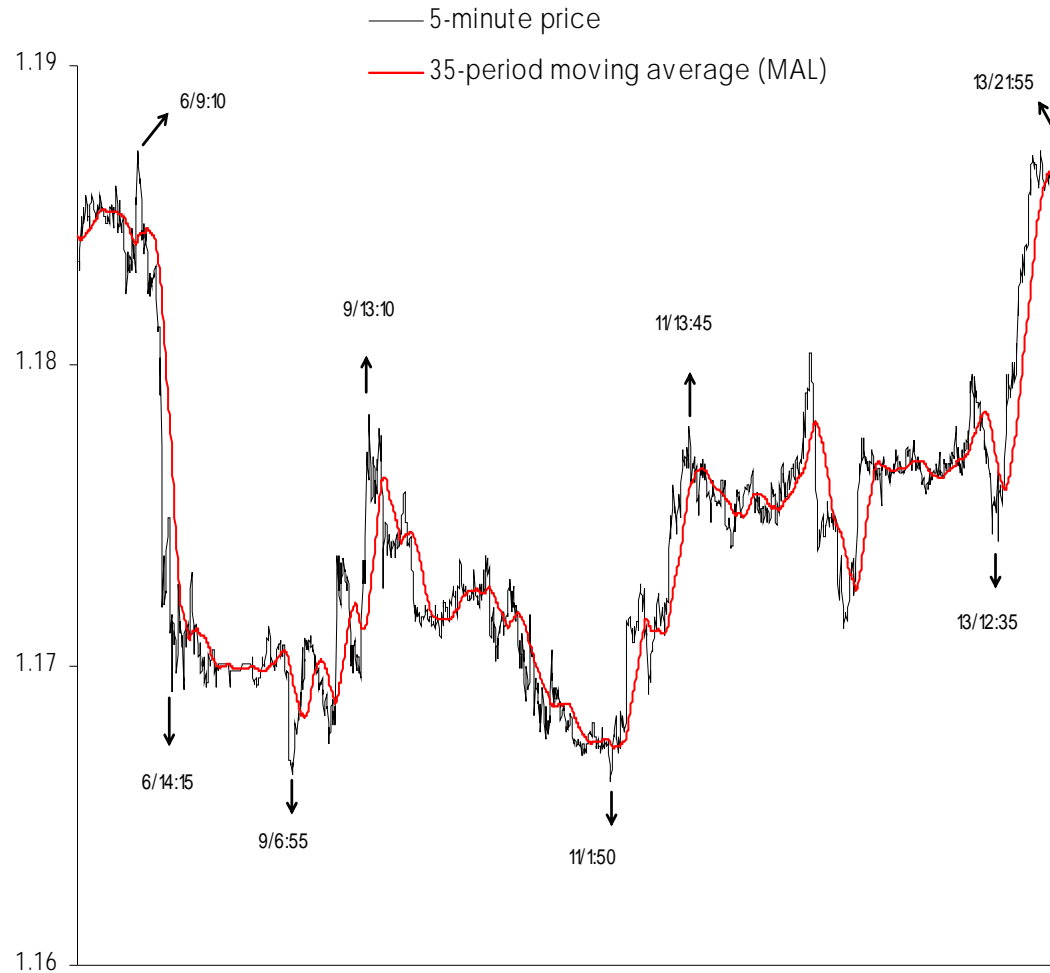
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- High transaction volumes stem from market makers
 - They provide liquidity for convergence to fundamentals
 - Speculation necessary and stabilizing
 - No endogenous overshooting
 - Deviations from fundamentals are due to shocks
 - Asset prices follow a random walk
 - Speculation based on past prices not profitable

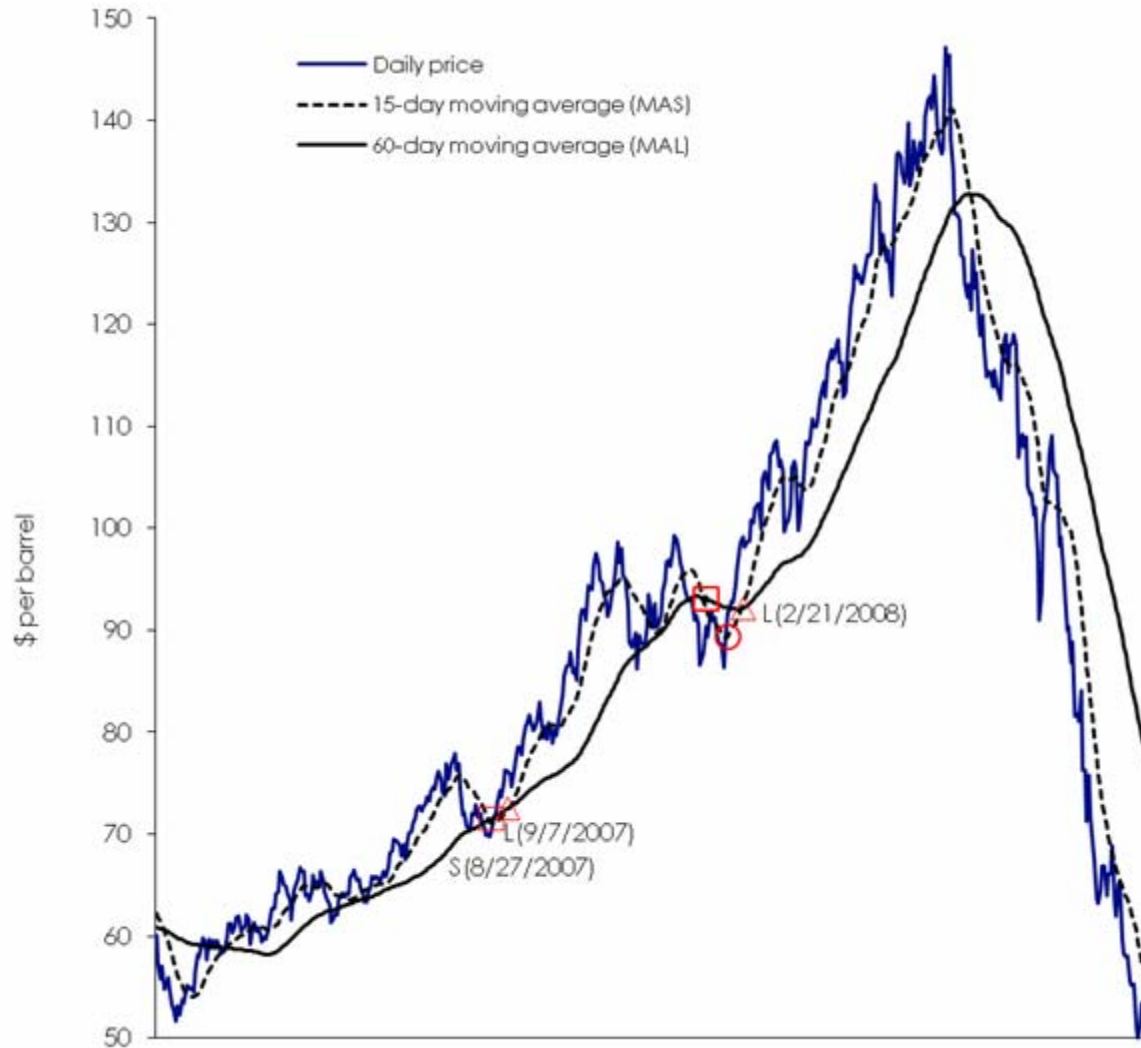
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- Imperfect knowledge >
 - Different models and information sets
 - Rational, emotional and social factors govern behaviour
 - Expectations often formed only qualitatively (directional)
 - Trading volume expands due to „bets“ of actors with heterogenous expectations
 - Price movements lengthened by technical trading

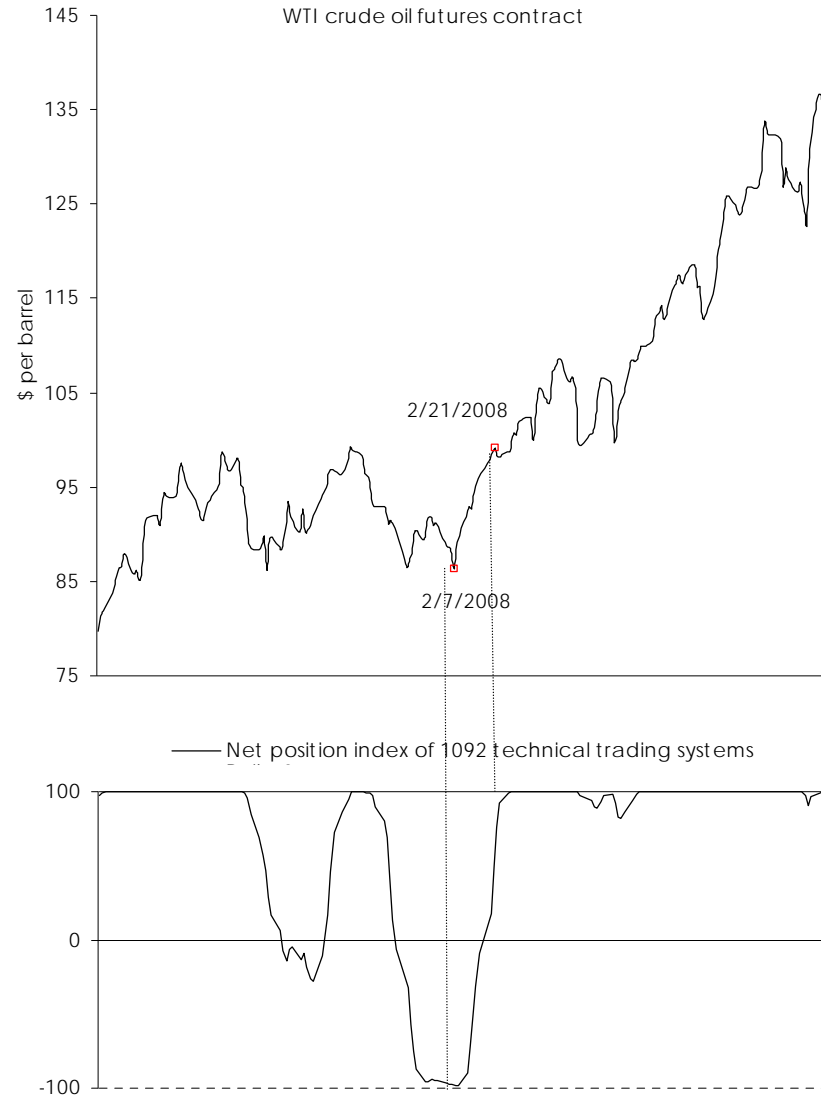
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- Dominance of "bullish" or "bearish" bias in expectations
 - Price runs in line with "market mood" last longer than counter-movements >
 - "Bull markets" and "bear markets" >
 - Asset prices move in irregular cycles around fundamentals
 - No tendency to converge
 - Fundamentals serve as "center of gravity"

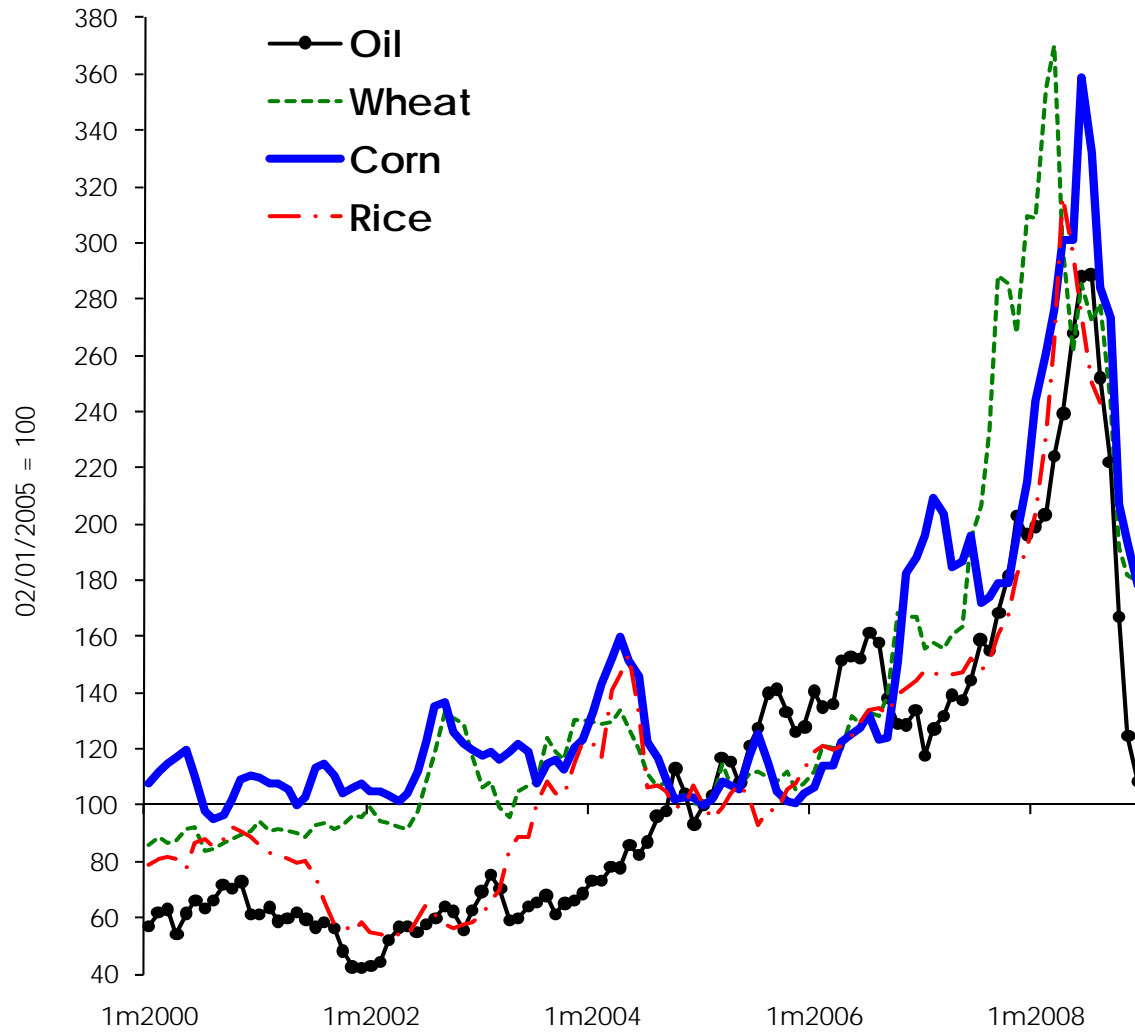


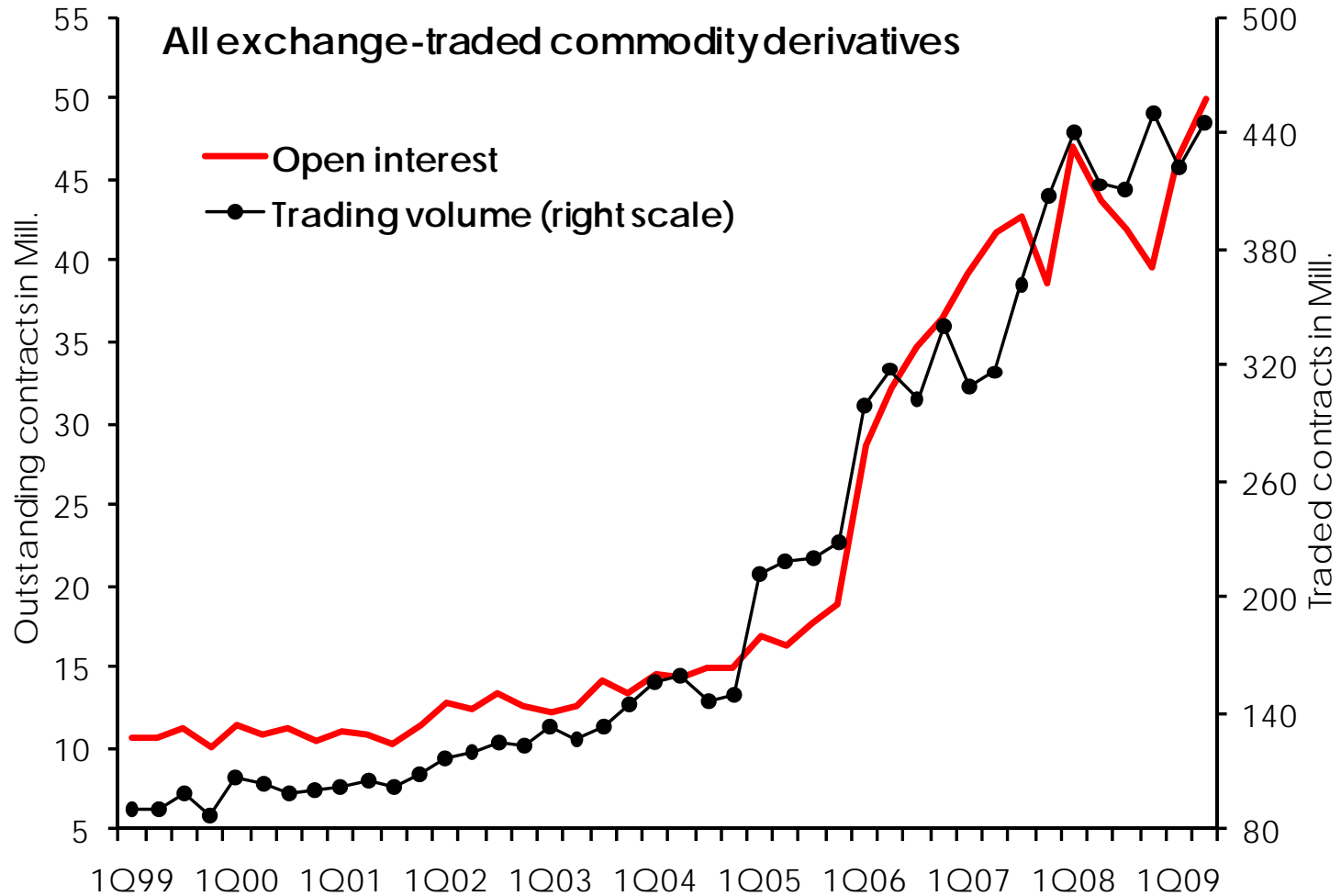




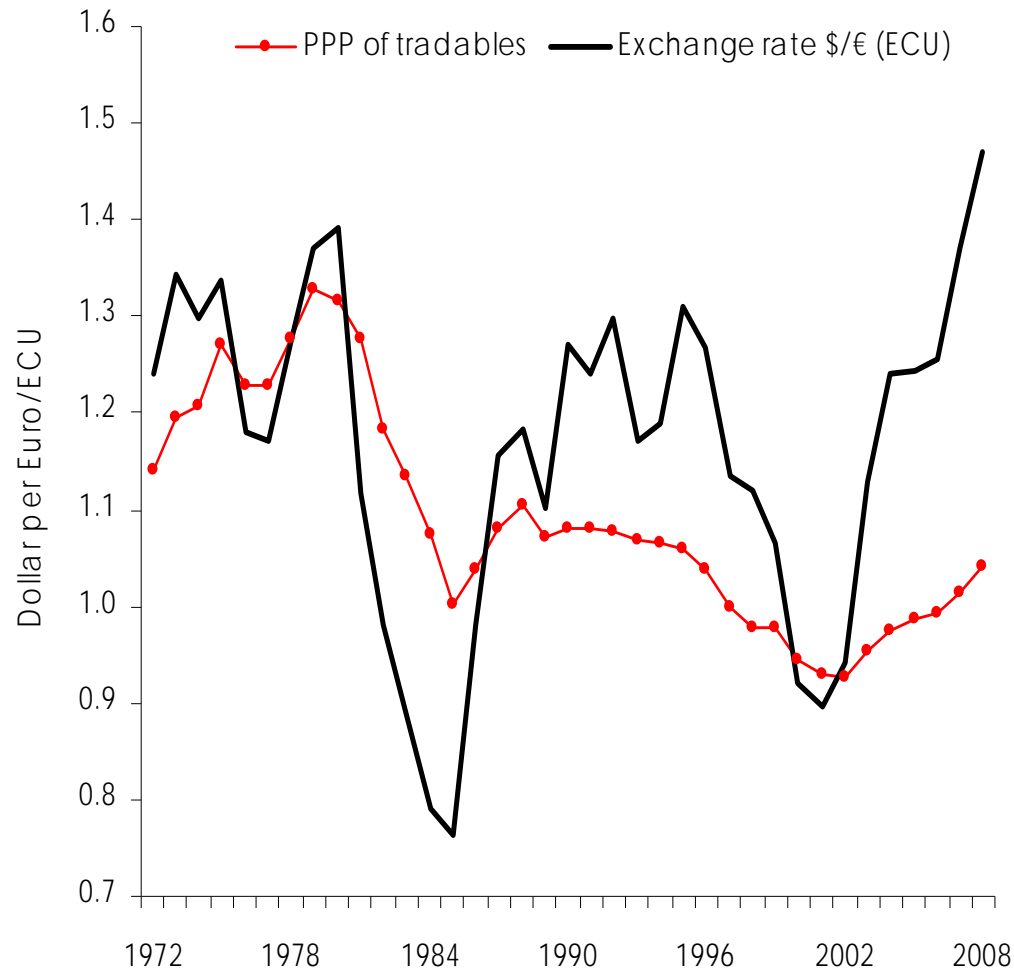




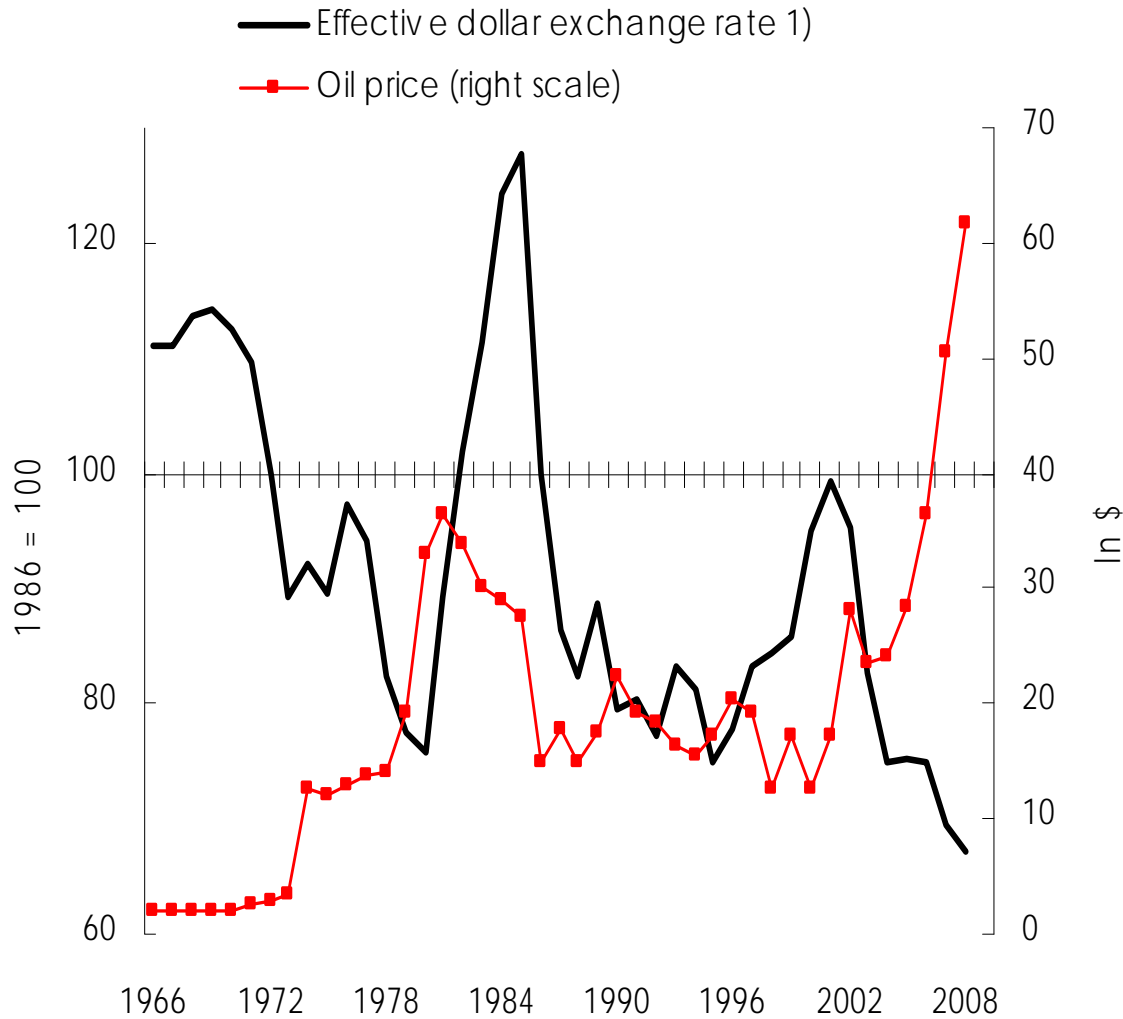




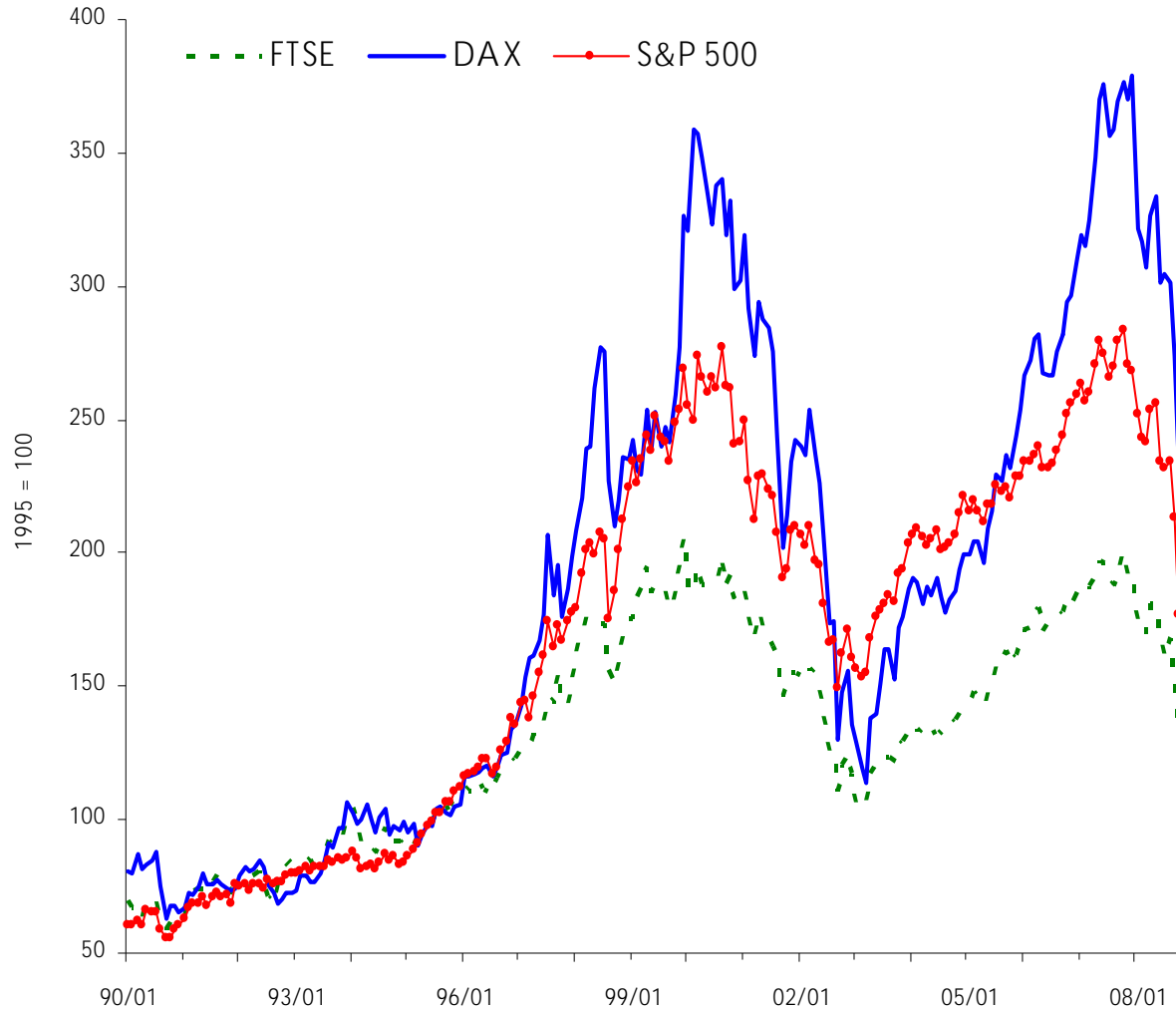
Dollar/euro exchange rate and purchasing power parity

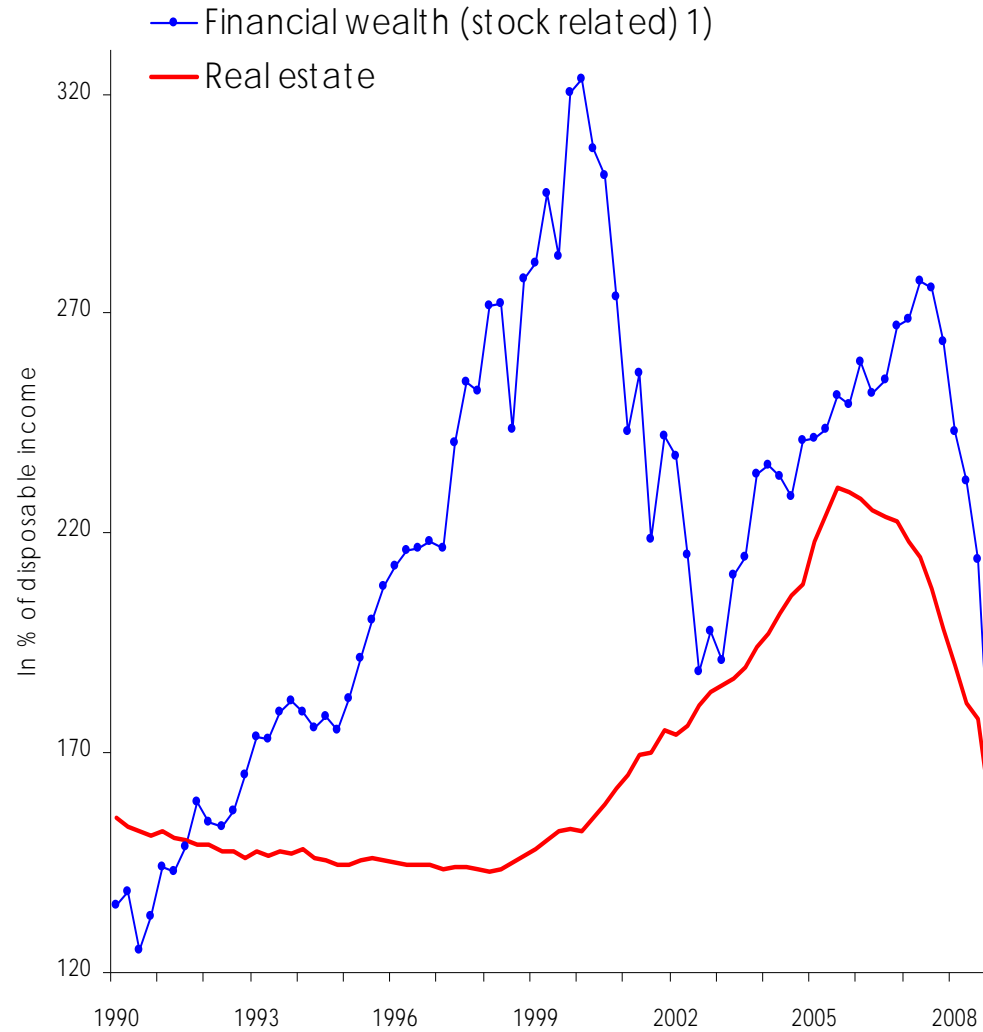


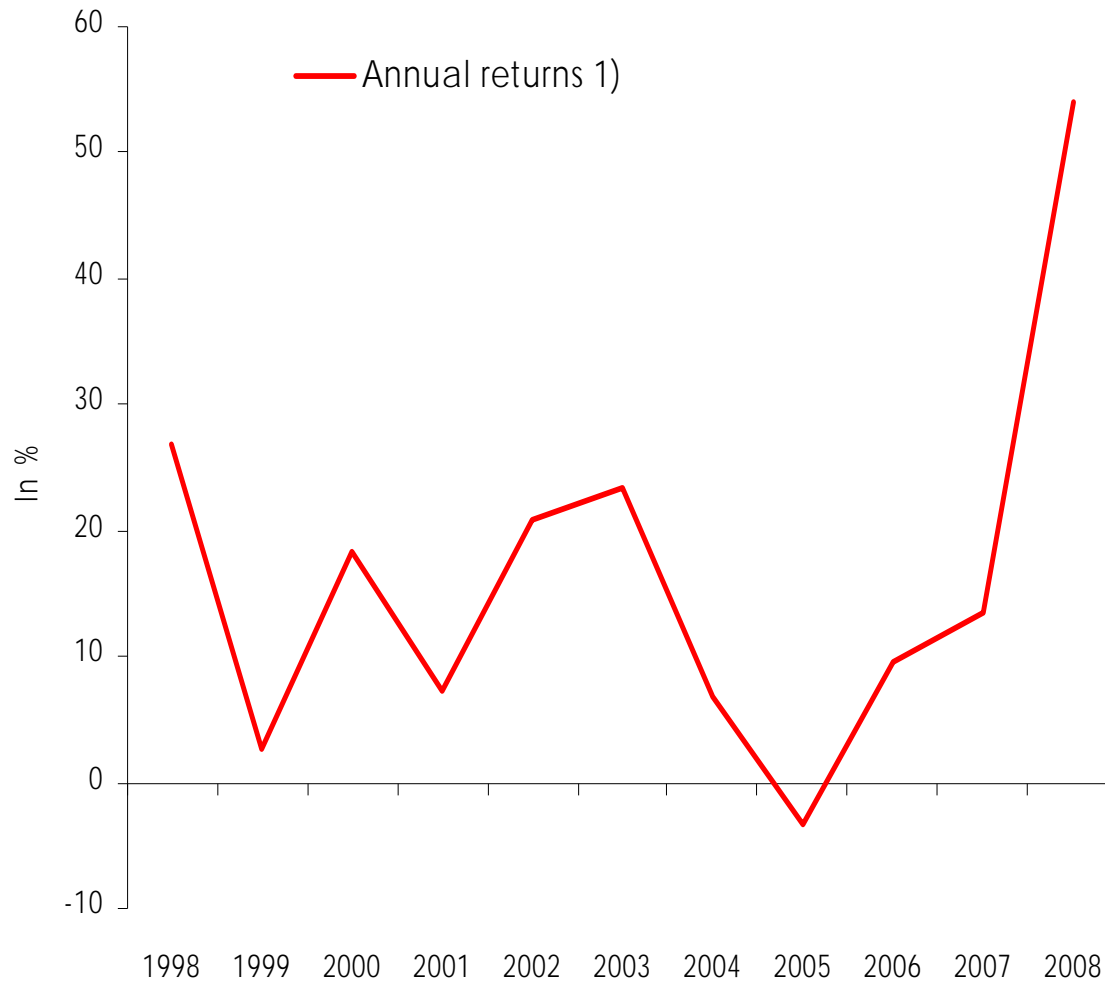
Dollar exchange rate and oil price fluctuations

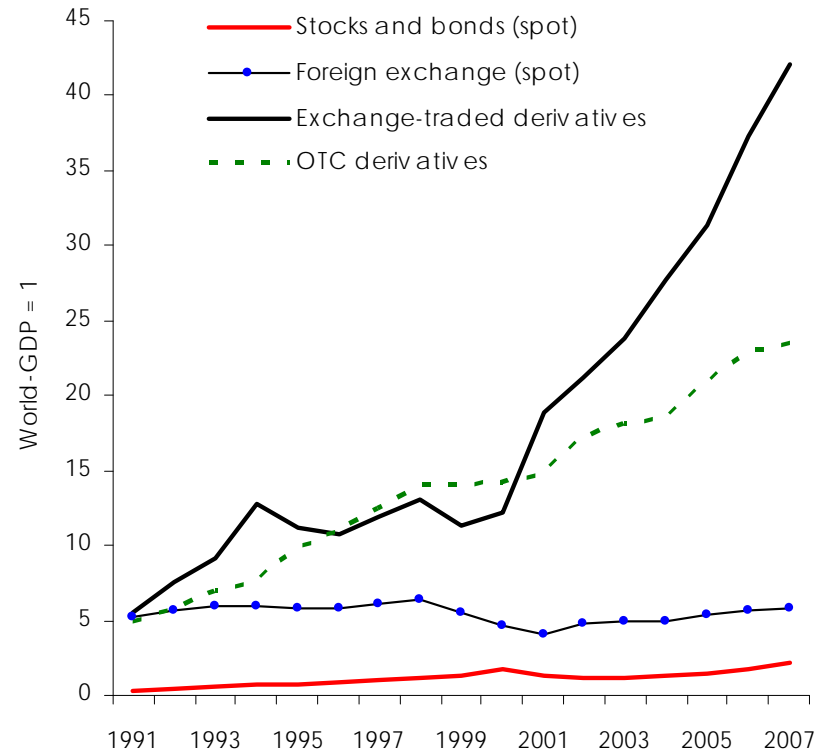
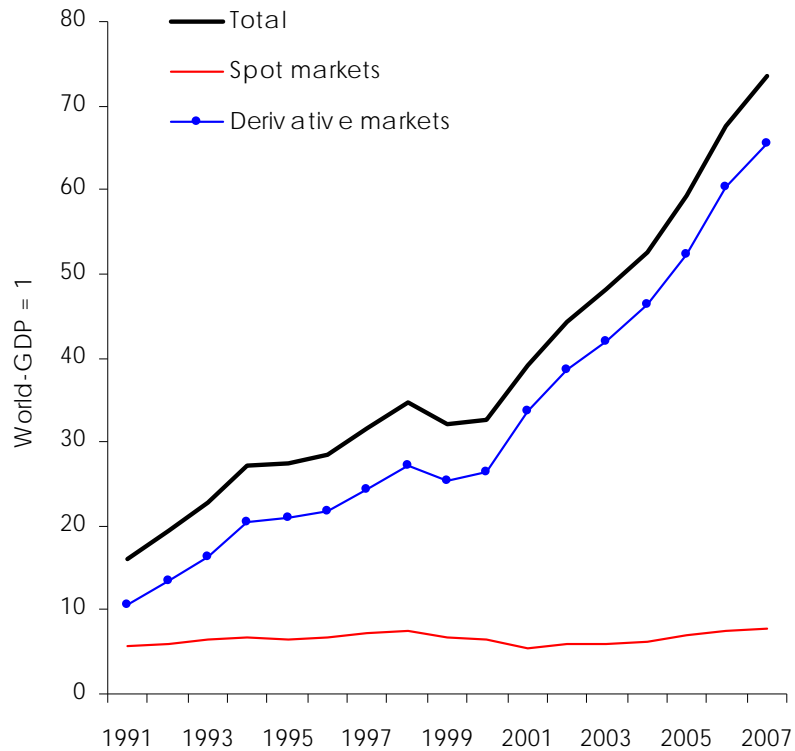


Stock price fluctuations in Germany, the United Kingdom and the US

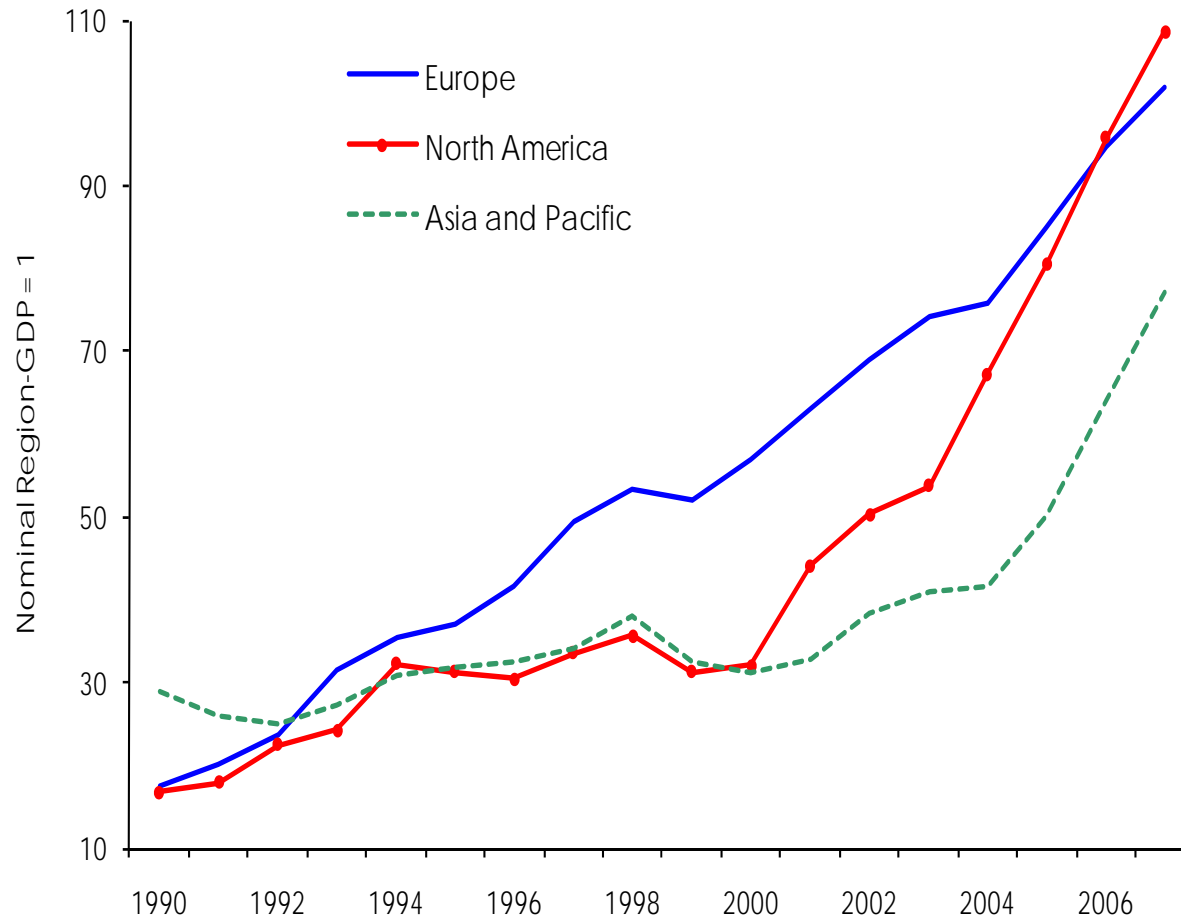








Overall financial transactions by regions



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- Growing discrepancy between real and financial transactions.
 - Speculation in derivatives markets grows fastest.
 - Asset prices fluctuate in a sequence of „bulls“ and „bears“.
 - Due to the accumulation of short-term price runs.
 - A FTT would affect specifically very short-term transactions with high leverage >
 - Dampens long-term asset price fluctuations.

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- Target 1: Stabilization of exchange rates, commodity prices and stock prices:
 - Short-term volatility
 - Extent of booms/busts over the long run >
 - Dampen the „manic-depressive“ price fluctuations
 - Target 2: Generating revenues for
 - Fiscal consolidation
 - Other policy goals, in particular at the supranational level (EU budget, development aid)

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- Generalizes the Keynes-Tobin-concept:
 - All financial assets treated equally
 - Tax rate is small, e.g., between 0.1% and 0.01%
 - Tax base for derivatives: Notional (base) values >
 - Higher leverage > higher cash requirement
 - „Real-world-transactions“ are not taxed
 - Implementation: Making use of electronic settlement systems (Fedwire, TARGET, CLS Bank, CHIPS)

WIFO ■ Assumptions of the revenue estimation

- Tax base:
 - All transactions of „financial assets“
 - Spot und derivatives
 - On exchanges and „over-the-counter“ (OTC)
- Three tax rates: 0,1%, 0,05%, 0,01% of asset value
- Three scenarios about the reduction of trading due to the FTT (differentiated by types of instruments)

		Germany			United Kingdom		
		Tax rate			Tax rate		
Reduction in transaction volume		0.1	0.05	0.01	0.1	0.05	0.01
Transactions on exchanges							
Total	Low	1.840	1.179	0.442	7.232	4.737	1.841
	Medium	1.320	0.920	0.390	4.980	3.616	1.618
	High	0.799	0.574	0.338	2.723	1.950	1.393
All transactions							
	Low	2.274	1.468	0.557	13.770	9.096	3.585
	Medium	1.609	1.137	0.491	9.338	6.885	3.144
	High	0.943	0.682	0.425	4.902	3.585	2.700

WIFO ■ Hypothetical FTT receipts II in % of GDP

		Europe			World		
		Tax rate	0.1	0.05	0.01	0.1	0.05
Reduction in transaction volume							
Spot transactions on exchanges							
Total	Low	1.623	1.038	0.387	1.528	0.976	0.363
	Medium	1.166	0.812	0.342	1.100	0.764	0.321
	High	0.707	0.484	0.296	0.671	0.462	0.278
All transactions							
	Low	3.260	2.129	0.823	2.411	1.565	0.598
	Medium	2.257	1.630	0.724	1.688	1.205	0.527
	High	1.253	0.893	0.624	0.965	0.682	0.455

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- Step 1: Transactions on organized exchanges in EU (Germany and UK would be sufficient)
 - Step 2: OTC-transactions within Euro area.
 - Step 3: Global OTC-transactions (including foreign exchange).
 - Administrative costs extremely low due to electronic settlement systems.
 - FTT would be highly concentrated on countries with big financial centers.
 - Tax circumvention not (very) relevant due to low tax rate and network externalities.