Comments from Global Unions[1] on draft IMF Working Paper,
***Taxing Financial Transactions: Issues and Evidence*, August 2010**

The IMF's working paper on financial transactions taxes (FTTs), authored by Thornton Matheson, is a welcome contribution to the knowledge and debate about FTTs. Our comments question some of the analysis and information provided, but we wish to note the important contributions at the outset.

Following the release of a preliminary version of the IMF paper prepared for the G20 on taxation of the financial sector, of which the final version was posted in June 2010[2], representatives of Global Unions expressed the view that the analysis of FTTs presented in that report was incomplete as compared to the preferred options put forward. We suggested that the IMF should provide information about existing FTTs in G20 countries and other financial centres; explain how they function and assess their strengths and weaknesses; and explain how a broad-based FTT could be designed and how any technical issues in implementation could be resolved.

The IMF's new working paper on FTTs provides considerable information on those topics in sections III and V. The paper shows that different forms of FTT exist or have existed in most G20 countries as well as in other important financial centres. A weakness of most of these – explaining in some cases why they were abandoned – has been their limited nature, which made them easy to avoid by designing other types of financial instruments or by moving transactions away from exchanges to over-the-counter (OTC) venues, for example. The paper finds that, in order to be effectively applied, an FTT must be broad-based and notably include derivatives and cover OTC as well as exchange transactions.

The working paper furthermore provides some useful discussion about appropriate rates for FTTs. It does not provide detailed estimates of revenues that FTTs could generate, contrary to the analysis of the IMF's preferred options in the report prepared for the G20, but it does acknowledge that a broad-based FTT would generate substantial revenues. Most governments and civil society organizations that currently support FTTs, including ours, do so because of the enormous financial resources that are required to repair the continuing costs of the global financial and economic crisis, including reducing the unacceptably high rate of joblessness, and to fulfil important development assistance and climate-change finance commitments that governments have made.

Many organizations have also supported FTTs because they would contribute to dampening damaging speculative bubbles, an issue that is dealt with in section IV of the IMF's paper called "The Economics of Securities Transaction Taxes".

Section IV of the working paper raises several questions. We note that it frequently cites studies concerning the possible impact of FTTs on financial markets that appear out of

[1] These comments were prepared by Peter Bakvis of the ITUC/Global Unions' Washington office and Pierre Habbard of the Trade Union Advisory Committee to the OECD (TUAC)
[2] IMF, *A Fair and Substantial Contribution by the Financial Sector: Final Report for the G20*, June 2010

date given the enormous changes in financial markets that have taken place in recent years leading up to the near collapse of the global financial system in 2008. We note that many of the studies the paper cites when underlining the possible negative effects of FTTs date from the 1980s or early 1990s, a world in which derivatives and hedge funds barely existed. By 2007, as the paper notes, world financial transactions represented 70 times world GDP, almost three times the multiple of 1995, and the exponential growth of transactions has been concentrated in derivatives.

The paper cites five studies concerning the argument that FTTs can reduce liquidity and slow price discovery, all but one of which date from the 1980s and 1990s. How applicable are these in an equity market where, as the paper notes in the case of the US in 2009, 60 per cent of trades are computer-driven and largely based on following, and exacerbating, price trends?

A core argument of Section IV of the IMF working paper is that an FTT would lower asset values. Since most transactions of financial assets are currently exempt from taxation in most countries, whereas transactions involving other goods and services are taxed, one wonders why the paper does not focus on the relative impact of ending the current exemption for financial transactions. One could equally argue that the values of non-financial goods and services are depressed through taxation (with consequent negative impacts on the level of employment of those who produce them) but, at least among those who recognize the need for government revenue, one does not often see that used as an argument to end all taxation of "real economy" goods and services.

Additionally, making the point that FTTs would result in lower values of financial assets would seem to confirm the arguments made by many FTT supporters that they act against asset price bubbles, although the IMF paper states that it has found no evidence to support that claim. The paper does mention that the establishment of an FTT would have a progressive distributional impact since high-income households possess a disproportionate share of financial assets. Given the sharply increased inequality of income and wealth distribution, to which both the IMF and World Bank are paying increasing attention as obstacles to development[3], this would seem a non-negligible impact.

Some comparisons that are made as arguments against the FTT seem of very limited relevance. The argument is made, for example, that FTTs would not act against asset price bubbles because high transactions costs have not prevented real estate bubbles. Another comparison is made with value added taxes (VATs) to argue that taxation in the financial sector should be designed on the same principles as a VAT in the real economy and only tax the "value added" by the asset owner so as to avoid the distortive effect of an FTT entailing multiple layers of tax on some transactions.

---

[3] See for example: IMF, *World Economic Outlook: Globalization and Inequality*, October 2007; World Bank, *World Development Report 2006: Equity and Development*, 2005

Neither of these comparisons appears relevant or useful to the high frequency, computer-driven, short-term trading that characterizes the bulk of securities and derivatives trading today, particularly in the US. The paper does not explain, for example, what is the "value added" by those who engage in such short-term trades and why the rules of appropriate taxation in real-economy production processes should apply to short-term high frequency financial trading.

The paper acknowledges that FTTs could dampen the risk of "herding" behaviour by decreasing this kind of short-term trading, but then argues that the FTT would be distortive because short-term trades are subject to higher effective tax rates than assets held for longer periods. The US financial system, undistorted by either an FTT or adequate regulation, produced the near financial collapse of 2008 that destroyed trillions of dollars worth of financial assets, so one could argue adding a little "distortion" that slows down these kinds of short-term trades may actually be good both for the stability of financial systems and for the real economy.

Proponents of FTTs have never claimed that they can or should be a substitute for adequate regulation. When the IMF working paper argues that asset price bubbles caused by excessive leveraging could be more effectively prevented by increasing margin requirements or collateralization during market upswings than by an FTT, it is not clear why the paper presents these options as mutually exclusive.

The paper in fact recognizes that the effective tax rate of an FTT would rise with leverage, thus discouraging leverage and acting against asset bubbles. Is it not reasonable to think that the US, for example, where monetary and regulatory authorities so spectacularly missed the asset-price bubble of the mid-2000s, could benefit from having the back-up of a tax that helps dampen speculative bubbles even if capable regulators should ideally be able to intervene appropriately and at the right time?

The working paper concludes this part of the discussion by stating that more research is needed on the effect of transaction costs, and therefore FTTs, on long-term volatility and asset bubbles. Though obviously additional research would be welcome, we are surprised that no such studies seem to have been carried out, assuming the IMF researchers surveyed work carried out by the Financial Stability Board and member countries, given the high importance of this issue. In any case, even absent such studies, the preponderant logic, including that presented in the working paper, seems to support the argument that FTTs would help dampen speculative bubbles.

27 August 2010