Funding the Future

The incidence of financial transaction taxes

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The debate about financial transaction taxes has, at least in part, come to focus on who actually pays them.

My research shows that this may be the wrong question. The most important question is not the incidence of the tax on these transactions, but the incidence of the cost of these transactions. If, as the opponents of the tax argue, the tax charge will fall on ordinary people then it follows that the excessive charges made by banks to fuel their own profits and to pay the wholly unreasonable rewards of bankers also fall on ordinary people. That is something of an own-goal on their part. It is also somewhat simplistic.

Realisation that it is is the incidence of the profits of banks and bankers that really matters in this issue, and the consequent understanding that financial transaction taxes will seriously cut the opportunities for both banks and bankers to profit means that, as I argue in the report *Taxing Banks* and *in the video that follows, there is actually a perverse paradox that would come into play if a financial transaction tax were introduced on currency trading for certain, and in all likelihood on derivatives, swaps and bonds.*

The perverse paradox is that imposing the tax may eliminate a quarter of all financial transactions: this reduces the heat in the market, cuts out marginally profitable deals but leaves a majority intact, but as importantly it massively reduces demand for those bankers and financiers engaged in this activity, mainly in banks but also in the few hundred companies the banks largely deal with when undertaking these trades. The result is the companies the banks deal with save, considerably. They will do many fewer deals — maybe 25% less, I assume. So too do the banks. And because that saving is largely in bankers pay, and there will as a result be considerably reduced demand for bankers, the price for their services — now frequently in excess of £1 million a year, will fall considerably, so much so that the cost of supplying the service will fall far enough to ensure banks can still do so profitably whilst also paying the tax, albeit with banks probably seeing a fall in profits as well.

Those the banks deal with will, however, by seeing the real costs of trading fall through *firstly a fall in volume and secondly a fall in the cost of running their treasury departments and thirdly by probably seeing a fall in their charges form banks will in all likelihood be no worse off at all, whilst still seeing the same net outcome from their trades, albeit from reduced volume of activity. As such the chance of cost leaking outside the banks is low.*

That is a perverse paradox, maybe, but it is the consequence of asking the right question about this issue i.e. not who pays the tax, but who pays the excess cost now when there is no tax. And when the right question is asked the answer is that the tax will fall back within the banking sector and onto those excessively rewarded within it, but the cost of the tax to the rest of society of currency transaction taxes and taxes on derivatives and other products may be negligible, and when the benefit that the harmful activity of bank and bakers being curtailed is taken into account, will be wholly positive. That has to be an enormous win for society as a while — exactly as James Tobin predicted.

I explain this in more depth in this video:
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