Worstall's odd little note on Financial Transaction Tax...

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Tim Worstall, who likes to think of himself as my bete noire, but who is actually a rather pedantic former UKIP press secretary (which explains why most of the world treat him with all the respect due to such a person) has published what he calls a report for the Institute of Economic Affairs, the right wing fundamentalist think tank, on the subject of financial transaction taxes, or Robin Hood Taxes, if you prefer.

Well, I am kind to it to call it a report. Spread over 14 pages, six are blank or are titles, contents pages and introductions that add nothing of substance. Of the remaining pages most have less than half a page of text on them. Whilst I agree that volume does not equate to quality, in this case it does: the report is so flimsy as to evidence it is laughable.

So what does it say? First of all it agrees that an FTT is feasible. Some of us have always known that. At least that's been conceded now by Worstall. Better still, at least he only took half a page to concede the point. But that's where the good news ends.

Second, Worstall argues that the tax will not raise revenue. This argument is wholly premised on the claim he makes that the proposed EU charge will be levied at 0.1%. In the process he ignores the fact that, as Reuters notes:

Under the [EU] plan, stock and bond trades would be taxed at the rate of 0.1 percent, with derivatives at 0.01 percent.

Worstall never mentions the lower rate in his report. He entirely ignores the fact that most of the tax will be charged at a rate one tenth of that he uses for the purposes of his analysis. This is like considering the impact of having an income tax at a rate of 20% and using a rate of 200% for the purposes of the analysis. Unsurprisingly you would get a result from such an analysis somewhat bigger than most other commentators would predict. To put it another way, you'd just be wrong, as Worstall so very obviously is in this report by making such an elementary error.

Third Worstall assume that marginal rates of tax in Europe are between 40% and 50%.

That’s not true. Average overall rates in Europe are less than 40% based on research I will publish very soon and since most tax systems are regressive at the higher end where the impact of this tax is likely to be rates should be lower than he forecasts. That’s lazy on his part.

As is his claim that the tax could not happen because it is illegal in the EU. Well of course it is: there is no law that permits it right now so the law will have to be changed if we want a financial transaction tax. That’s that objection overcome.

As indeed is the further objection that the tax must be undesirable because it would be paid to the EU. There are three reasons for objecting to this argument. First, the EU has to be funded. Why may it not tax? Secondly, if governments permit this then what is his problem with that? The governance and accountability structures for such a decision are clear. Finally, on this issue, Worstall seems to assume that tax paid is always wasted. It’s an interesting idea, but of course wrong. Indeed, if his own argument that corporations can’t ever pay tax is right (with which I do not agree, for reasons noted, below) but about which he is adamant then by simply using the same incidence argument the entire benefit of this tax when collected cannot be for the benefit of any government as he argues but is instead passed on to people — an argument people like Worstall always ignore when discussing incidence. He gives no consideration to the benefit that they might derive as a result, or the dynamic consequence of it, for example on new investment, spending, resources for regions, the reduction of burden on indebted governments so they can provide essential services, and so on. It’s just all a cost according to Worstall, meaning his analysis is totally distorted. But he can’t make such a one-sided argument. If redistribution increases resources available to those who really need them in society, especially at a time when those with wealth are saving and so increasing the impact of the recession through the paradox of thrift, then his argument fails miserably. I contend it does.

As incidentally do his own arguments on incidence. He can’t both argue that corporations if charged to this tax will relocate transactions to avoid it and at the same time say that the incidence is never on corporations, as he does. Firstly, if the incidence is never on corporations they would take no action to avoid the tax. In his world of rational beings he can’t suggest corporations are both logical and yet would behave so irrationally to avoid a tax they will not pay. So the truth is vastly more complicated than he suggests and the mainly very old papers (1970s and 1980s) that he quotes in favour of his argument may have been selected for exactly the same reason. First, companies are not just bundles of contracts that mean they act merely as agents for human beings. This is what Worstall implies and it’s a claim about as close to reality as is belief in the Efficient Market Hypothesis — and as surely now reserved for the same sort of fantasists who think markets work as their economics textbooks describe, and who quote each other’s text books as supposed evidence that this is indeed the case rather than look to the real world they’d rather not embrace for evidence of what really happens.

I've addressed this issue many times before, and the extraordinary and I think near fraudulent evidence some supposed economists put forward to argue that it is always labour that pays the price of any tax but let me summarise my reasoning again. First, in addition to the obvious belief of management that the incidence of tax clearly is on their companies, there is much other behavioural evidence on this issue. Companies can, for example, very clearly choose in a great many cases when, where, in what form and to some degree in what amount they record transactions and so tax. They very clearly therefore decide who might bear that tax, where and when if that incidence is not on the company itself. That is enough to think this not a neutral issue.

Second, as I have argued, there is good reason to think in the case of financial transaction taxes that this incidence may indeed fall on labour — but not generic labour as Worstall argues, but the very particular labour of bankers who will suffer a loss of bonuses and maybe employment as a result. Given that the activities of a great many of these bankers has properly been described as 'anti-social' by Lord Turner there is considerable reason for thinking that a thoroughly desirable outcome with enormous gains for society itself. By ignoring this possibility Worstall shows that he thinks the only reason to tax is to raise revenue when that is just one of five reasons that I and others recognise, including the objectives of redistribution and repricing antisocial activity, which this tax undoubtedly does.

Third, if banks were split, as I and many others suggest, the chance that dealing on own account (which explains a substantial part of the transactions that will give rise to a financial transaction tax being paid) will not be capable of being passed on to ordinary customers in the way Worstall manages, constraining these transactions within investment banks in the main and therefore meaning most of the incidence will remain within the quite limited sphere of activity that these banks will influence, including their shareholders.

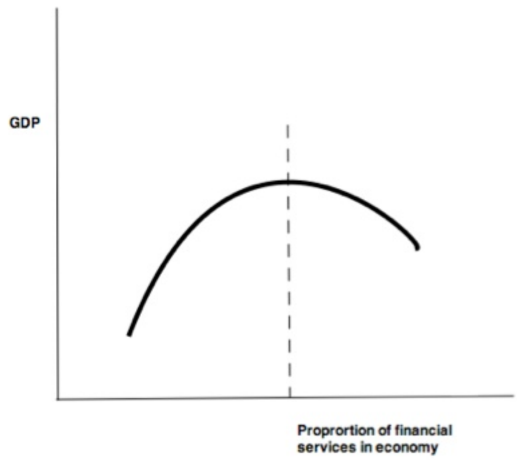
Next, to assume that the liquidity that financial markets often suggest exists is a good thing is a wholly mistaken assumption on Worstall's part. If there was less liquidity in these markets there would, very obviously, be much less volatility than we are witnessing at present, and much less chance that these markets could be used to mount the assaults on democracy that their Goldman Sachs' derived leadership currently seems to be undertaking. As important, this liquidity is illusory: when the markets really needed liquidity in 2008 it famously dried up, almost completely. The idea that liquidity is always by default good is simply not proven to be true.

Last, for now, given that what is clearly needed with regard to most capital investment is very clearly a long term view, and not the short term mania that currently passes for supposed investment management, there is actually very clear evidence that imposing a tax on short termism will increase the quality of decision making and reduce the burden of investment churning that is currently passed on to markets as a result of excessive, exploitative and deliberate abuse of the like of pension funds, where the members have no say in how their savings are abused in this way. The cost of capital may or may not increase as a result but the quality of return to investors will undoubtedly rise as a consequence, and that is what matters.

And this too is a characteristic of the failure of another Worstall's assumptions — which is that any fall in GDP must be a bad thing. I do suspect and even hope that an FTT will reduce GDP in the short term. I have every wish that the not just useless but also harmful activities of many involved in anti-social gambling at public expense be eliminated. Reducing GDP for this reason would be as welcome as a fall in GDP resulting from the ending of pollution or the ending of divorce — both of which add to misery and GDP at the same time. GDP is not a god to be worshipped for its own sake. But in this case there's more to it than that. As I argue in the Courageous State (chapter 12, for those with a copy, and this may be from a draft and not quite as finally published, but there will be little in it):

It's my suggestion that the UK has considerably too much banking and financial services activity for its own good. It's my belief that it represents an excessive proportion of economic activity. More than that: I believe that this excess actually squeezes out other more productive economic activity that would be of benefit to the UK.

Let me put this idea on a graph:



As the proportion of financial services in an economy rises then I am clearly suggesting that benefits can arise: money is an amazing thing with the power to release all sorts of advantages and it would be wrong to deny it.

But I am also suggesting that there comes a point over the longer term (and all that I am saying here is an analysis over time because the impacts being discussed arise over *years and even decades, not days and months) when those advantages can be outweighed by an excess of financial services in an economy. Too much banking can crowd out real money making in real business that makes goods and services people want and need. This is the widely recognised economic concept of 'squeezing out' in operation.*

The same can also be true of too much speculation within an economy as opposed to real wealth creation. It would appear glaringly obvious that having large numbers of intelligent people spending their lives gambling cannot be good for the generation of real well-being and yet this is encouraged in our current economy. Since speculative trading is not the same as making things the diversion of real talent towards the moving of money around the financial system can eventually deny talent to the production of goods and services, education and art, care and creativity that any society really wants and needs.

When this happens — when squeezing out occurs - I suggest that the long term GDP of a country actually goes down because there's too much banking going on. And that's what this graph shows: there is a tipping point beyond which too much speculative banking is not good for us. It's my suggestion that we reached that point some time ago and that we are on the right hand side of this graph now, where the return from banking is a reduction in our national income.

In other words: am apparent fall in GDP from banking right now will increase GDP overall because banking is very clearly squeezing out ore productive activity in our economy that cannot happen whilst mispriced activity takes place in banks because as, for example the Mirrlees Commission even agrees, they're under-taxed when it comes to transactions (which is, I note something Worstall ignores). This logic is similar to that of the supposed 'squeezing out' of the private sector by the state so beloved by the right wing, even if without apparent evidential support in that case whereas in this case the support for the claim that key resources (and most especially mathematically literate graduates) are denied to productive industry as a result of the destructive impact of banking is overwhelming.

So has Worstall made a case that FTT's fail? No, not at all! Far from it in fact. What he has done is instead assembled a polemic, based on a mistaken assumption of the tax rate to be used and then, relying on just one quote from the EU has said, by applying inappropriate tax rates for the EU zone and assumptions on corporate behaviour for which there is no evidential support in the real world coupled with myths that because there is no law allowing an FTT at present they must be illegal, claimed that they therefore cannot work. And very amusingly he has then claimed that his resulting logic is unassailable.

With the very greatest of respect to Tim, that's just not true at all. As I have shown, the whole edifice on which he mounts his argument is flawed, his choice of evidence is flawed, his data is wrong and the resulting claim is just a piece of wishful thinking no doubt designed to keep those who fund him and the Institute of Economic Affairs very happy. But that's not the same as making an irrefutable case. That he has utterly failed to do — not least because of Worstall's own refusal to consistently apply his own logic, which means, as I show here, that his resulting logic is so partial it is obviously wrong.

Financial Transaction Taxes are according to Tim Worstall feasible. On that we agree. But most importantly, they'll also work. On that we don't agree, but only one of us is right. And I'm very confident that a proponent of the economics that has brought the world's markets to their knees is not the one on this occasion who comes even vaguely close to the truth. Bad luck Tim, therefore. It's 2 out of ten for effort, but no points at all for getting near the right answer.