

Liquidity and stability or taxation and change the whole system?

For more than one year different (mainly) European politicians have called for options on how the financial sector could make a contribution to pay for government interventions during the crisis, how to raise future tax income and even to use such funding in fighting poverty in developing countries. The discussion itself became more colourful when back in August Lord Turner, head of Britain's Financial Services Authority (FSA) supported such an idea and Gordon Brown, the British Prime Minister recently shared his views and presented some proposals at the Group of 20 meeting in November.

At this stage the discussion around the so-called Tobin tax are supported by some groups (e.g. the IMF by Dominique Strauss-Kahn) but was also for instance refused by the US Treasury Secretary Timothy Geithner and Yves Mersch, European Central Bank Governing Member, who called the initiative a 'scurrilous idea' (according to a Dow Jones news wire).

What to tax?

Today's call for a financial transaction tax includes a wide range of products: foreign exchange markets, transactions in bonds, stocks, commodities and all kind of derivatives. But the talks are just beginning.

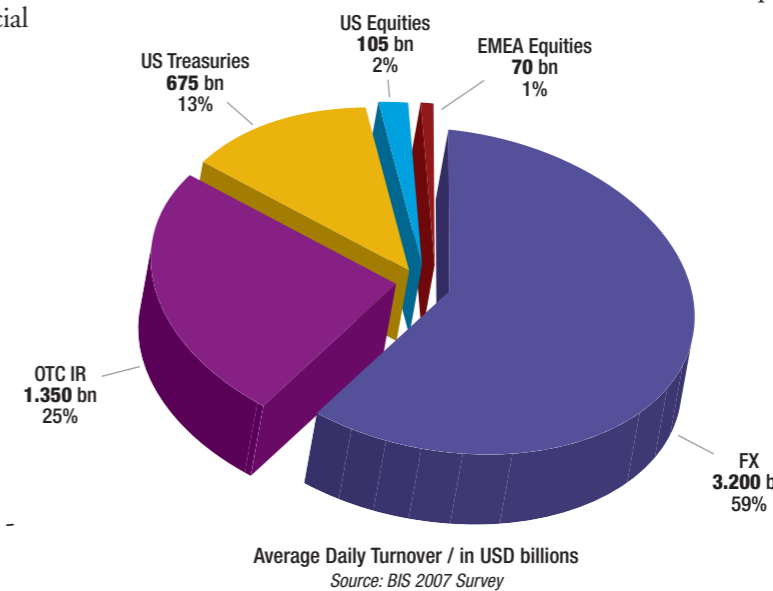
The original idea of the Tobin tax was on currency speculation, one per transaction. In 1971 James Tobin proposed such a tax on currency trading to reduce or avoid speculation in the wake of the collapse of the Bretton Woods system. His proposal was for a tiny percentage tax (suggestions range from .1% to .5% in these days) – on speculative transactions only. For this idea (which was never implemented) and his work on financial markets, Tobin won the Nobel Prize in 1981.

Manfred Wiebogen,
President ACI
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The global financial crisis has revived the discussion on a financial transaction tax as a means of discouraging international currency speculation, help shrink 'a swollen financial sector' and perhaps simply to raise funds as an international (or national) source of revenue.

	Daily traded volume	0.1% transaction tax revenue
Global FX	3.200 bn	\$ 3.200.000.000
OTC IR	1.350 bn	\$ 1.350.000.000
US Treasuries	675 bn	\$ 675.000.000
US Equities	105 bn	\$ 105.000.000
EMEA Equities	70 bn	\$ 70.000.000
		\$ 5.400.000.000 / day

One of the main arguments for such a tax is the debacle of the past two years in the financial markets. But stop – aren't the backers of Tobin mixing all the financial markets? Is the reason for this new initiative really fighting future crisis or just simply a mechanism for raising money? Many arguments are aimed towards the enormous volume traded in the daily FX markets. Let me emphasize, foreign exchange didn't cause the current financial crisis nor is it guilty in any aspect for this crisis! As President of the ACI The Financial Markets Association, I'm calling for more rational and responsibility in all discussions about financial markets and taxation. What the markets now need is trust! But let's face the truth: and that's definitely our problem - Trust was lost on 9/15 in 2008, when Politics let Lehman collapse. - A new tax will not bring back trust.



pay for it? FX is a class on its own and the OTC IR, mainly the short term products, helped solve the crisis by providing the markets and the banks balances with short term liquidity. If they are to be targeted by politics, there is something wrong.

Politicians have to be very cautious in not discouraging the markets from short term funding (financing). A taxation here will again damage the short end of liquidity, causing a run on long term funding and dry up short term liquidity/trading again. But do investors (long term lenders) want to be only in long term placements making them unable to take out their money in difficult times as short term-lenders did during the past year? Again, the markets need trust and liquidity. Repo business in the short term market has already eroded a part of the overall liquidity but markets do not need additional uncertainties.

Hedgers and speculators are important to provide and to keep liquidity running. We have to accept the fragility but also the necessity of over-trading. A constructive discussion of such a transaction tax immediately will call for rational appeal. If the voices from the industry are not heard the whole financial system will be forced to change.

ACI The Financial Markets Association (www.aciforex.org) would be more than happy to obtain your point of view. Should you have any comments or proposals you can contact managingdirector@aciforex.org

Fall of mankind

To understand the numbers involved I shall breakdown some official figures from the past: Considering a 0.1% transaction tax at daily Global FX traded volume of USD 3.2 trillion the daily tax income could equal USD 3.2 billion a day! – (or just half the amount by a reduced rate to 0.05% or so).

This of course is just a simplified demonstration of the discussed topic. As this chart and matrix illustrates, over the counter interest rates (OTC IR) and the Foreign Exchange business are totalling around 84% of the overall above figures. Again, both product groups absolutely have nothing in common with the current financial crisis but should they be forced to