



## Global Views

### Goodman on FX Trading and the Tobin Tax

**Michael Goodman,**  
Senior Global Markets Analyst

.....  
**Penserra Securities LLC**  
20 Broad Street, Suite 2602  
New York, NY 10005  
+800.456.8850

156 Diablo Road, Suite 340  
Diablo, CA 94526  
+925.258.1970

.....  
**Contact:**

**Global Equity Trading**  
Andrew Frank | +800.456.8850  
andrew.frank@penserra.com

**U.S. Equity Sales & Trading**  
Robert Goddard | +925.258.1970  
robert.goddard@penserra.com

**Fixed Income Capital Markets**  
Ed Prado | +866.651.8947  
ed.prado@penserra.com

#### **Previously on Penserra Global Views...**

Last time we delved into the world of currency, the carry trade, and how it directed international money flows. There was, if you recall, a lot of money involved. And, where there's a lot of money there's always a government lurking right behind to get its cut. So, today we're going to look at justifications for taxation of currency trading, both economic and political. Some foreshadowing: if a politician starts talking about the economic benefits of taxing FX trade you should start jumping up and down and yelling, "liar liar pants on fire."

#### **Tobin or Not Tobin, That is the Question**

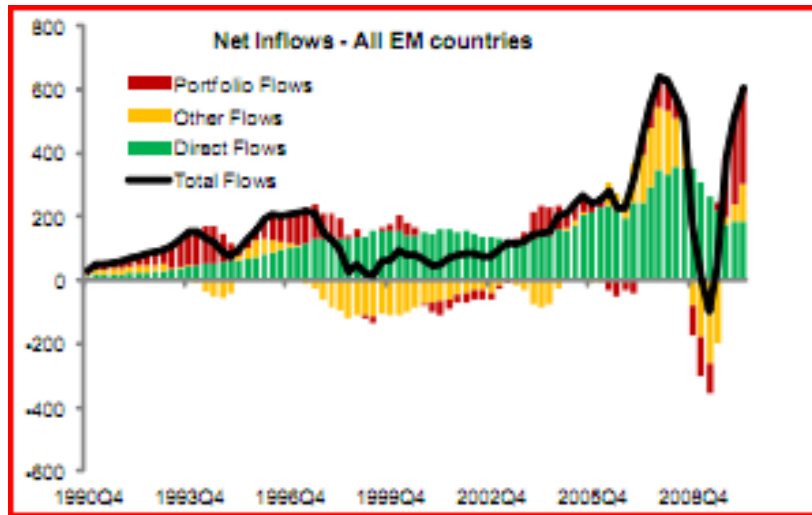
A Tobin tax, in addition to being the inspiration for a truly awful Shakespearian pun, is the proposed mechanism for taxing currency trades. More recently the term has also been somewhat expanded to include taxing all large banking transactions. First proposed in 1978 by James Tobin, the tax is a roughly 0.5 percent on large currency transactions. In the language of taxes, that's obviously a small amount, but in the language of trading I don't need to tell you what a 50 basis point surcharge on a trade will do. A Tobin tax in an ideal economically modeled world is supposed to accomplish two things. First, the tax discourages speculation, and the accompanying

currency destabilization that can occur, by taxing high volume trading on small exchange rate changes. Second, the tax provides a more complicated purpose in monetary policy that addresses the issues of capital inflows and outflows.

#### **We Have Enough Money, Thanks**

One of the biggest challenges that emerging markets like the BRIC countries face is dealing with rapid flows and large volume foreign investment. As you can see in the first graph on the next page (which I have taken from an IMF report from February, 2011 about managing capital flows\*) even the collapse of the western financial world had a temporary, albeit significant, impact on money inflows. That's great for all sorts of things, like infrastructure investment and financial market development. However, that much money flowing into a country can destabilize currency, cause inflation and crush export competitiveness. So, what is a giant emerging market country like Brazil to do when its currency appreciates 36% against the dollar? You guessed it, impose a Tobin tax, which they did in 2009, instituting a 2% tax on portfolio inflows to discourage, among other things, a carry trade. As you can see from the second chart (from the same report as the first) the implementation of the tax, which is indicated by the red line had a mixed effect

Disclaimer All materials are provided for information purposes only and should not be used or construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security. Penserra Securities LLC is not responsible for gains/losses that may result in the trading of these securities. All information is believed to be obtained from reliable sources, but there is no guarantee that the information supplied is accurate, complete or timely. There is no guarantee or warranty with regard to the results obtained from its use. There is no guarantee of suitability or potential value of any particular investment or information source. You acknowledge that your requests for this information are unsolicited and shall neither constitute nor be considered investment advice. Past performance is not an indication of future performance. Investors are encouraged to consult a registered broker or investment adviser before making any investment decisions. The interpretations and opinions expressed herein are solely those of the author and not of Penserra Securities LLC as an organization. Member: SIPC, FINRA.



While it did slow the appreciation briefly, its long term impact seems murky at best. It is a result which is consistent with the IMF’s findings about inflow controls like the Tobin Tax. While the theory behind their implementation might be sound, the real-world efficacy is still up for debate.

**It’s Always Politics**

Now you know what a Tobin tax is used for. You also know that it is not used in developed countries with stable currency. So, when you hear noises in France and Germany and even England about supporting a Tobin tax recognize it for what it is not. It is not a call for stability or economic regulation. It is simply code for another way to raise revenue. Intelligent minds might differ as to whether or not it is a good idea to raise revenue off the back of FX trading. The American political climate won’t let it happen, but the Europeans seem to be increasingly in favor.



Let’s not mince words about what the Tobin tax is. Attempts to justify the political grab in economic terms are misleading at best and outright lies at worst. If the E.U. wants to increase taxes on the financial sector, and use a tax on currency trading to do it, there’s a discussion to be had about the merits of that case. But, that discussion cannot start until we all move away from the idea that the Tobin tax is an appropriate financial regulatory tool in non emerging markets.

\*The full report is a very interesting read titled “Recent Experiences in Managing Capital Inflows—Cross-Cutting Themes and Possible Policy Framework” and is readily available on the IMF’s website. If you have the time to read it I highly recommend it. But you probably don’t, that’s what you have us for.