



ADAM SMITH
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Regulatory Corporatism

Lord Turner and the Tobin tax

By Miles Saltiel

Introduction

On 26 August, *Prospect* published its September issue. This included a conversation between Lord Turner, chair of the Financial Services Authority; and a miscellany of great-ish and good-ish: John Gieve, former deputy Governor of the Bank of England and also former PUS of the Home Office over the period of accounts which the Auditor General declined to approve; and Paul Woolley, whose early career included a stint as advisor to the mid-70s parliament presided over by Harold Wilson and who is now a senior fellow at the LSE; plus a couple of journalists, Jonathan Ford, the commentary editor at Reuters; and Gillian Tett, an assistant editor at the *Financial Times*.¹

In his conversation, Turner deplored the banks' "socially useless" activities and proposed a "Tobin" tax, that is a tax on financial transactions. This stirred up a storm in the press on the following day, leading to expressions of support from the Liberal Democrats and green campaigners, silence from the Labour and Conservative parties and dissent from City figures, the Treasury (*sotto voce*), the FT and the white Times. Below we summarise the economic, political and personal context, examine the history, rights and wrongs of a Tobin tax, as well as asking what Turner was up to and what this incident tells us about the state of the debate on UK banking policy.

Economic and political context

First, the economic position. Let us start by drawing a distinction between the reality of the banking crisis of 2008-9, brought on by chronic loose money and regulatory failure, primarily in the US but also elsewhere in the OECD; and the popular perception of banking dereliction, created by an extraordinarily successful piece of spin by governments and their apologists. The bank crisis itself is well and truly over. The TED spread measuring banking risk

is now at its lowest since February 2007 at 22.1. But before we tip our hats to the authorities for acting decisively to see off the crisis, let's remember that their slapdash policies led to it in the first place and that their recent clumsiness with the banks (including pushing public anger their way – as noted, so far with great success) has created new hostages to fortune.

Second, the outlook. Global output has been falling, but is now returning to growth ahead of expectations. In fact this was never 1929, rather 1998, that is the Asian crisis which rebounded promptly. This said, global unemployment is still on the up, probably peaking in twelve months' time.

Third, the politics. Throughout the OECD, governments find themselves saddled with commitments impeding future public expenditure for several electoral cycles, if not a generation. Many are bridleing at their inability to reap political capital from the banks they have taken over or otherwise supported. Now they are trapped anew, by promises to ease private borrowing which no-one can keep till the banks rebuild their balance sheets. Having bitten off more than they can chew, leaders in the US, the UK, France and elsewhere are reverting to the tactic which worked out so well for them last Autumn: diverting popular anger by huffing and puffing – in this instance on banking bonuses. But this won't work forever, so any politician with *kishkas* is looking out for new red herrings. How about a Tobin tax?

A Tobin tax

In 1972, James Tobin proposed a tax to penalise short-term speculation in currencies – "sand in the wheels" of what he saw as excess liquidity. Originally he proposed a rate of 1% on transactions, subsequently lowered to between 0.1% and 0.25%. The scheme was taken up by green campaigners as a source of funds, but was otherwise largely forgotten

for more than 20 years. It was revived by the 1998 Asian economic crisis and intermittently elsewhere thereafter, for example during Nicholas Sarkozy's 2007 presidential campaign when he proposed such a tax on hedge funds.

Tobin himself has had some second thoughts. In *Der Spiegel* on 3 September 2001, he distanced himself from the greens but continued to argue for the bedrock of his scheme.

I have absolutely nothing in common with those anti-globalisation rebels. Of course I am pleased; but the loudest applause is coming from the wrong side. Look, I am an economist and, like most economists, I support free trade. Furthermore, I am in favour of the International Monetary Fund, the World Bank, the World Trade Organisation. They've hijacked my name...The tax on foreign exchange transactions was devised to cushion exchange rate fluctuations.²

A cogent argument against such a tax comes from an unlikely source, the *City Notebook* column in *The Guardian* on 30 August 2001, which asserted that currency speculators are

...an exceptionally useful lot, working day-in, day-out, risking their own wealth to supply a thing called liquidity. Without liquidity, markets dry up, prices become volatile and goods become difficult to shift.

The column continued that a Tobin tax would impede this useful work and

[the] net result is that everyone involved - producer, trader, buyer - becomes poorer, not richer.³

Personal background

Lord Turner, the former Adair Turner, was nicknamed "Red" Adair after conspicuously failing to represent his membership when he led the CBI between 1995 and 2000.⁴ Many in the City have vivid memories of top finance directors and pension fund trustees of the day spitting with fury when his name came up. They objected in particular to his catastrophic stance on Gordon Brown's abolition of Advance Corporation Tax relief, which has denuded pensioners of £5bn per year ever since. He did this in a classic flip-flop: before Labour's first budget he warned against such plans;⁵ but afterwards Brown was able to invoke him as a supporter.⁶

This established Turner as a reliable associate of New Labour, especially on pensions, but he missed his footing after agreeing in 2002 to lead a commission on the subject. His conclusions three years later give a clue to his cast of mind. He correctly diagnosed that Britons are loath to save for pensions, particularly at the beginning of adult life when it would do most good; and that pension arrangements are opaque in the extreme. He nonetheless failed to recognise that we then act rationally by "over-investing" in domestic property, the price of which is supported by time-hallowed restrictions on land-use, which qualifies for borrowing on attractive terms, and which benefits from full tax relief on sale. Absent other capital (those elusive pensions or legacies), we "trade down" when the kids leave home, avoiding any pressing social evil. In 2005, his report made nothing of this, instead calling for intervention on a scale which horrified his masters.⁷ The report was scuppered by Gordon Brown before it was published and has subsequently been roundly ignored.⁸

Turner had become a team-player who would accept a hospital pass more or less gracefully, leading Gordon Brown to appoint him to re-invigorate the slightly shop-soiled FSA in September 2008. Under his leadership, however, the regulator has done nothing to rectify its undistinguished record. It remains at odds with the Bank of England, has come under a death-sentence from the Tories and in consequence is unable to attract new staff. Most of all, the energetic remarks of its new leader are starkly at odds with the reality of the situation. The next item on the agenda ought to be reforming the high-street banks, distorted by the crisis into government-supported near-monopolies, and then getting out. But the authorities have dithered, instead making much irrelevant noise. This brings us more or less up to date.

Turner's remarks

In September's *Prospect*, Turner joins in a wide ranging discussion, exploring the position of the banks at some length and coming up with a generally balanced set of remarks. Even so, he signs up to today's leftish mantra: that the intellectual basis of the last thirty years of market dominance has been demolished, leaving policy-makers without a compass. What grabbed the newspapers' attention, however, was his musings upon a Tobin tax on financial transactions, not just to correct their "socially useless" character, but also the disproportionate size and returns of the UK's financial sector, not to say imbalances between the sell-side (investment banks) and buy-side (insurers and pension funds).

The rights and wrongs

The compass of the markets may have been bloodied by the recent crisis but seems to be emerging unbowed. The main reason for markets is not Turner's straw man of the "efficient market hypothesis" (a technical aspect of investment theory), but their time-tested capacity to innovate constructively and to correct errors on the fly. This holds, as it always has, provided that government doesn't shave the dice, as the Americans did with the decades of politically-inspired loose money which led to the recent crisis. By contrast, consider government's notorious failure to correct errors on the fly, often for generations (in the UK, think welfare dependency, transport infrastructure or public procurement).

Contrary to Lord Turner's musings, there is no evidence that the UK financial services sector is disproportionate. First, the sector operates internationally, so UK GDP is irrelevant as a comparison. Second, the sector is bound to increase disproportionately as societies become wealthier. Third, it is smaller than in the US overall; and far smaller than in the richest US states. In truth, it is impossible to know the proper size of the sector or what financial innovation is going to work ahead of time and what will turn out to be "socially useless", all points which Turner concedes elsewhere in his remarks.

Turner's allegations of imbalances are unfounded and misguided: consider the size of buy-side giants Fidelity, Legal and General or Aviva. They are also incoherent. For example, Turner claims he wants to help the sell-side but lays into hedge funds, its most innovative part and one unimplicated in the recent crisis. There is a separate issue about agency risk, that is insiders feathering their own nests, but this applies to sell- and buy-side alike and is best remedied with transparency and competition, something the FSA has conspicuously failed to ensure.

A Tobin tax would also be plain immoral: it's just another stealth tax, introduced for reasons Lord Turner himself admits to be populist.

Finally, as a practical matter, a Tobin tax would be impossible to enforce domestically. It could only be done internationally, in which case the size of the UK's GDP is irrelevant: better to compare global output. In reality, such a scheme could not take effect for a generation, if not a century.

Dealing with the problem

If the problem is that rewards for participants in the sector are disproportionate – a matter which Turner saw as populist – better correct this with more effective policy measures, in particular increased competition. This is desirable for other reasons, for example reducing the incidence and consequence of future contagion. But the FSA continues to refuse this fence.

If the authorities want traction on the sector, they need to stand up to banks and insurers, neither treating them as political clients, nor scolding them by loudhailer. They should decline to bolster the financial monopolies fostered over the last cycle and intensified over the 12-month emergency. Instead, they should be laying the ground to demolish them.

A Tobin tax is a lazy alternative to reform. It eases the way for us to reconcile ourselves to unreconstructed banking structures. No great distance to accept near-monopolies, part-owned and universally controlled by the state, which assumes the right to appropriate any surpluses at will. In short corporatism. Arrangements of this kind were last advocated by such talents as Benito Mussolini, Juan Perón and Edward Heath. Such a scheme would be calamitous to innovation, the only differentiating feature of an advanced economy like the UK, not to say economic (and in due course political) freedom. It is also moral hazard gone mad.

So far from a solution, Turner's proposals hold out the risk of making things far worse. Ventilating such proposals opens the door to a Faustian pact, in which Turner's agency continues to flinch from its part in the heavy lifting of reforming the status quo, in return for his part in delivering a piece of the City's action to his masters. Remember his form on this, his proposals for greater state intervention in pensions, a debacle of its own making. If he is really weighing in for corporatism, someone needs to raise a voice for competition. Fortunately, Lord King has reminded us that "too big to fail" just means too big.⁹ This looks like the next instalment of the policy debate.

Why, oh why?

The record shows that Lord Turner relishes a high-wire approach to policy-making, with positions sometimes precariously ahead of his constituents, but also that he is a canny operator. He knows that these proposals exceed their stated purpose of defending the FSA against criticism;

he's been around for long enough to expect their incendiary character to generate a press feeding-frenzy, particularly at the end of the silly season. So why make them? Maybe he simply let his mouth run away in congenial company and said more than he should. We've all done it. But he has declined to backtrack, telling Sky News that if bankers' pay "is an issue you want to talk about, you have to talk about things like tax".¹⁰ So he evidently means his comments to be heard, incendiary or not.

This leaves us with two alternatives: that his remarks were a personal or professional *cri de coeur*, or that he is acting as a stalking horse. We cannot rule out the former. Turner is only human and is personally and professionally under pressure. His New Labour patrons are on the run, while the FSA he was appointed to rescue is going down with all hands before our eyes. It would be far from dishonourable if, as might any Captain with decent sea-legs, he were laying down smoke to cover an eventual *saute qui peut*.

Or maybe, good team-player that he is, he has taken another hospital pass, ventilating ideas not normally to be repeated in respectable company. This would be to prepare opinion on behalf of – and now we come to a semi-colon; on behalf of whom? The natural suspects would be the New Labour patrons under whose auspices he has made his career for the last thirteen years. But no evidence for this is to hand. Indeed, Labour's chancellor has been as robust in his dismissal as he ever is, with anonymous aides saying

*...no such taxes were under consideration. Mr Darling insists that the banking industry in London should continue to play a leading role in global finance... This isn't on the table," said one government official. "If Adair Turner has views on tax policy, perhaps he should go and work in the Treasury..."*¹¹

On the other hand, shadow chancellor George Osborne was one of the few not to dismiss Turner's proposals outright. A source close to him said, "Lord Turner is always worth listening to".¹² Others have speculated that Osborne will have been pleased with some of Turner's comments.¹³ This follows what others have seen as a rapprochement between the two, after Turner said he was agnostic about Osborne's plan to scrap the FSA and merge its regulatory functions with the Bank of England. "You can argue this either way," he is reported to have said.¹⁴ So perhaps this was a sacrificial gambit to cultivate the next circle of patrons.

Conclusion

Whatever Lord Turner's intentions, his pyrotechnics do nothing for the reputation of anyone involved. They may be telling us that his New Labour cronies have saddled themselves with banking responsibilities which are beyond them. Or that we are in for a bout of huffing and puffing from the Tories, working up a wedge issue no matter how populist. Either way, we learn that in the agony of his current demise, our chief financial regulator has no qualms in flirting with the intellectual and moral vacuity of corporatism. Stand by for elucidation in his Mansion House speech on 22 September, ahead of the Pittsburgh G20.

About the author

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Endnotes

- 1 'How to tame global finance', Adair Turner and others, *Prospect*, September 2009, London.
- 2 English translation of the original article from *Der Spiegel*, displayed on the Jubilee Research website of the New Economic Forum, London. http://web.archive.org/web/20050306201839/http://www.jubilee2000uk.org/worldnews/lamerica/james_tobin_030901_english.htm
- 3 *The Guardian*, 30 August 2001. <http://business.guardian.co.uk/story/0,3604,544098,00.html>
- 4 The original was Paul Neal "Red" Adair (18 June 1915 to 7 August 2004), a celebrated oil-well fire-fighter from Houston, Texas.
- 5 Reported by the BBC, undated. <http://www.bbc.co.uk/politics/97/news/05/0515/cbi.shtml>
- 6 Reported by *Hansard* Parliamentary proceedings, 27 November 1997. <http://www.parliament.the-stationery-office.com/pa/cm199798/cmhansrd/vo971127/debtext/71127-01.htm>
- 7 'Second Report of the Pensions Commission', 30 November 2005. <http://www.webarchive.org.uk/wayback/archive/20070801230000/http://www.pensionscommission.org.uk/publications/2005/-annrep/annrep-index.html>
- 8 *ABC Money*, 25 November 2005. <http://www.abcmoney.co.uk/news/2520051415.htm>
- 9 Remarks by Mervyn King, Lord Mayor's banquet, Mansion House, 17 June 2009.
- 10 *Sky News*, 30 August 2009. <http://news.sky.com/skynews/Home/Business/City-Watchdog-Chief-Turner-It-Is-Up-To-Government-To-Take-Action-If-It-Wants-To-Curb-Bank-Bonuses/Article/200908415371269?>
- 11 *Baltic Course*, 30 August 2009. http://www.baltic-course.com/eng/editors_note/?doc=3747
- 12 *Daily Mail*, 28 August 2009. <http://www.dailymail.co.uk/news/article-1209359/Head-FSA-backs-tax-transactions-combat-swollen-city-bonuses.html>
- 13 *Financial Times*, 27 August 2009. <http://www.ft.com/cms/s/0/08943b5a-926a-11de-b63b-00144feabdc0.html>
- 14 International Political Economy Zone, 27 August 2009. <http://ipezone.blogspot.com/2009/08/turner-n-hooch-fsa-boss-talks-tobin-tax.html>