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Developing a sustainable tax base through a financial transaction tax: An analysis of suitability for the New Zealand environment

Simoné Pycke¹, Jagdeep Singh-Ladhar² and Howard Davey³

Abstract

The purpose of this research is to address whether a Financial Transaction Tax (FTT) should be implemented in New Zealand in order to address the effect of an ageing population on the New Zealand tax revenue base. This paper considers the wider theoretical literature on the implementation of a FTT. In considering the literature it draws out the main arguments for and against the imposition of a FTT. This paper identifies that New Zealand has an imminent issue with needing to adapt the tax revenue base because of the impact of its ageing population. The advantages and disadvantages of a FTT are considered in the New Zealand context. The key advantages are that a FTT can generate increased revenue and reduce speculative behaviour in financial markets. The disadvantages identified in the literature are that there are limited means to accurately predict the actual revenue generated by a FTT, or the potential negative effects on market trading within a country. There is also concern that a FTT needs to be applied on a regional or wider global basis for a FTT to be effective. In the New Zealand context further research could include considering the amount of potential revenue that can be generated by a FTT, assessing the potential effect of a FTT on the government-funded superannuation saving scheme, KiwiSaver, and whether the imposition of a FTT would be more effective on a regional scale across Australia and New Zealand. This paper provides an initial explorative study of the potential for a FTT to be implemented in New Zealand and areas for future research.

Key words: Financial Transaction Tax, Tax base, Tax policy, Tobin tax, KiwiSaver, New Zealand

¹ PwC Hamilton, EY.

² Assistant Lecturer, Waikato Management School, University of Waikato, Hamilton, New Zealand:
Corresponding Author – ladhar@aikato.ac.nz.

³ Professor of Professional Accounting, University of Waikato, Hamilton, New Zealand.

1. INTRODUCTION AND BACKGROUND

1.1 Introduction

The purpose of this paper is to consider whether a Financial Transaction Tax (FTT) should be implemented in New Zealand. This is an exploratory paper that will review the relevant literature on the implementation of a FTT in New Zealand. The literature review will first consider the information relevant to the problem of an ageing population and related issues. The second part will focus on the literature relating to the implementation of a FTT, its associated tax revenue raising benefits, criticisms and implementation considerations. This research will provide a platform for the consideration of whether implementing a FTT could be a feasible means of extending the New Zealand tax base primarily to provide the funding necessary to support the ageing New Zealand population.

This paper is divided into five sections. The first section provides the background to the context of the research. The second section describes the method chosen for the study. The third section uses literature to identify and discuss issues regarding ageing population in the OECD nations, with a specific regard to New Zealand. It also uses literature from a wide variety of sources covering FTT, its current global status, its advantages, criticisms and implementation considerations. The fourth section focuses on whether New Zealand may have a potentially strong reason for the implementation of this tax. This paper will finish with a short conclusion on why New Zealand holds a sound position on an explorative level for the implementation of this tax to aid the funding of its ageing population. This paper is explorative in nature and as such specific legislation and regulation and implementation issues, including numerical taxation percentages, should be considered for future research.

1.2 Background

The demographic change occurring as larger proportions of the populations move into retirement is causing global concern. The concern is related to the perceived lack of social infrastructure available to support an increased number of retirees.⁴ An increase in the size of the retiring population highlights a double problem caused by decreasing income tax revenue and increased retirement expenditure. There has been some recognition of the future implications of these trends in academic research as well as public debate, with government agencies and economic development units suggesting that new methods of revenue generation is important. These trends will be discussed in the literature review in Section 3.

New Zealand has one of the highest proportion of retirees among OECD countries. The New Zealand government provides various health and social welfare infrastructure to support retirees. Given the potential for increased costs associated with a larger number of retirees in the future, this explorative research paper will consider whether New Zealand should consider the implementation of a FTT to mitigate some of the fiscal pressure. There are limited resources on the topic of a FTT

⁴ James Obben and Monique Waayer, 'New Zealand's Old-Age Pension Scheme and Household Saving' (2011) 38(9) *International Journal of Social Economics* 767; David E Bloom, David Canning, Günther Fink and Jocelyn E Finlay, 'The Effect of Social Security Reform on Male Retirement in High and Middle Income Countries' (Working Paper No. 48, Program on the Global Demography of Aging, 2009).

in the New Zealand context, and as such this paper provides a platform for future research into the more specific considerations of implementation.

2. RESEARCH DESIGN

This paper uses an exploratory research design; it will define a FTT and the specific characteristics that are associated with it; it will help formulate the problem more precisely for future investigation; and lastly also establishes a basis for future research. As such, a literature review that covers the initial exploration of this topic within the New Zealand and overseas contexts will be undertaken. The public nature of FTT discussion provides this paper with the opportunity to use a mixture of expert, non-expert and opinion literature. These sources contain a mixture of both quantitative and qualitative research information, and as such the authors benefit from prior, informed and heavily-resourced information. Future research into this topic could adopt a more empirical approach.

3. LITERATURE REVIEW

This literature review considers the aging population problem from both global and New Zealand perspectives. It highlights why an ageing population is of economic concern to current and future taxpayers. The literature review will provide the context for the next section of this paper, which will consider the advantages and disadvantages of a FTT. The latter is undertaken in order to assess whether a FTT may be a practical means of revenue generation for governments in order to support ageing populations and the associated fiscal pressures.

3.1 Ageing population demographics

Population ageing has long term fiscal and structural impacts.⁵ Reports by the United Nations and OECD confirm declining fertility, lifestyle choices and improved healthcare have resulted in a noticeable demographic shift upwards in the global mean population age.⁶ The extent of the demographic changes may be underestimated.⁷ New Zealand is also experiencing large upward shifts in the structural and numerical age of its population.⁸ The change in New Zealand is primarily driven by declining birth rates, improvements in life expectancy and the fact that ‘baby-boomers’ born between 1946 and 1965 are retiring. These findings are supported by the United Nations reports on changing global demographics and lower fertility rates.⁹ It is

⁵ Natalie Jackson, ‘The Demographic Forces Shaping New Zealand’s Future. What Population Ageing [Really] Means’ (Working Paper No 1, University of Waikato: National Institute of Demographic and Economic Analysis, 2011)

<<http://researchcommons.waikato.ac.nz/bitstream/handle/10289/6539/NIDEA%20Working%20Paper%20No%201.pdf?sequence=1>>; Susan M St John, Claire Dale and Toni Ashton, ‘A New Approach to Funding the Costs of New Zealand’s Ageing Population’ (2012) *New Zealand Population Review* 55.

⁶ United Nations, ‘World Population Prospects: The 2010 Revision. United Nations, Department of Economic and Social Affairs’ (Population Division, Population Estimates Section; 2010); Organisation for Economic Co-operation and Development, ‘Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries’ (OECD, 2011).

⁷ David E Bloom, Axel Boersch-Supan, Patrick McGee and Atsushi Seike, ‘Population Aging: Facts, Challenges, and Responses’ (2011) 41(1) *Benefits and Compensation International* 22.

⁸ Jackson, above n 5.

⁹ United Nations, above n 6.

estimated that between 2010 and 2060 people aged 65 will increase from 13 per cent to 26 per cent of the population and the percentage of the population aged over 80 will triple.¹⁰ Increased life expectancy also means that a larger group of people will be in retirement for longer periods. Fewer people will be entering the workforce but will have to carry the burden of funding more retirees. This is a fundamental demographic shift.

3.2 Economic implications of demographic ageing

As the population ages there will be higher demands for pensions, healthcare, and elder-orientated goods and services.¹¹ The structural impact of the shifting proportion of young to old will have an increasing impact on the amount of tax received by governments. For countries such as New Zealand, with a policy of collecting taxes over a broad base in order to keep taxation rates low, the contributions of the workforce to tax revenue are currently greater than other sources of taxation revenue. The problem with the ageing population in New Zealand is that it will lead to proportionately less taxpayers contributing to the tax base as more people retire from the workforce.¹²

The effect of population ageing is a focus of New Zealand government policy. In 2013 the New Zealand Treasury commissioned a working paper on the fiscal impact of population ageing. The purpose of the study was to examine the financial and social consequences for ageing populations. It built upon an earlier Treasury-commissioned report published in 2002 that identified specific economic issues that would arise for New Zealand with its ageing population. The earlier 2002 Treasury report focused on the economic impact of retirement and superannuation.¹³ The 2013 Treasury report found factors such as health, education and finances are relevant to the retirement age, however, the most influential factor in the decision to retire was around certainty of retirement income. The 2013 Treasury report findings recognised that as these ageing New Zealanders approach retirement, not only do they become reliant on support such as New Zealand Superannuation (NZS), but also on second and third tier benefits such as accommodation supplements and medical aid. The most significant implication for countries is on the collection of taxes as retirees leave the labour force reducing primarily direct but also indirect tax revenue collection. The 2013 Treasury Report notes that indirect tax revenue will fluctuate based on 'the changing pattern of expenditure over the life cycle'.¹⁴ In the New Zealand context indirect taxes include consumption taxes, such as Goods and Services Tax (GST). This means that the problem of an ageing population is twofold. There is an increased demand on services to support an ageing population, while at the same time there is reduced taxation revenue from the retired population.

¹⁰ Omar A Aziz, Christopher Ball, John Creedy and Jesse Eedrah, 'The Distributional Impact of Population Ageing In New Zealand' (2015) 49(3) *New Zealand Economic Papers* 207, DOI: 10.1080/00779954.2014.890023.

¹¹ Obben and Waayer, above n 4.

¹² Christopher Ball and John Creedy, 'Population Ageing and the Growth of Income and Consumption Tax Revenue' (Working Paper 13/09, New Zealand Treasury, April 2013) <<http://www.treasury.govt.nz/publications/research-policy/wp/2013/13-09/twp13-09.pdf>>.

¹³ John Stephenson and Grant Scobie, 'The Economics of Population Ageing' (Working Paper 02/05, New Zealand Treasury, March 2002) <<http://www.treasury.govt.nz/publications/research-policy/wp/2002/02-05/twp02-05.pdf>>.

¹⁴ Ibid, 3.

The next section will consider the specific impact of retirees on the collection of taxes in New Zealand by examining the New Zealand tax base model.

3.3 Effect of an ageing population on tax base

The New Zealand tax base is reliant upon the collection of taxes from three major sources: personal income, company income and GST.¹⁵

One notable change in recent years is that the proportion of revenue from individual income tax has decreased while the proportion of revenue from GST and company income tax has increased. Between the years ended June 2010 and June 2013, individual income tax reduced from 48 per cent to 39 per cent of total revenue, while company income tax increased from 13 per cent to 16 per cent of total revenue, and GST from 24 per cent to 32 per cent. This switch in tax revenue is partially attributable to the increase in the GST rate from 12.5 per cent to 15 per cent and reductions to individual income tax rates from 1 October 2010.

New Zealand has the sixth lowest GST rate at 15 per cent among OECD countries, however, proportionally the collection of GST as a consumption tax is the highest in the OECD.¹⁶ The high amount of GST collected reflects New Zealand's GST broad base, which has been extended in 2016 to include supply of digital services.¹⁷ On the other hand the contribution of individual income tax remains the main source of revenue in the New Zealand tax base. The change in New Zealand demographics means that in the future 'it is plausible to foresee changes in the tax base for income taxes'.¹⁸

3.4 Private retirement savings and other funding solutions

Funding solutions to the problems of an increasing number of retirees has typically focused on superannuation funding. New Zealand has a universal tax-funded state pension scheme called the New Zealand Superannuation (NZS) available by right to all residents over 65 years of age.¹⁹ NZS payments do not depend on prior earnings of an individual and are paid at a flat rate to all who are entitled to receive it.²⁰ In 2007 the New Zealand government introduced an opt-out workplace-based superannuation savings scheme called KiwiSaver.²¹ The purpose of the scheme is to encourage saving for retirement.²² KiwiSaver is funded by contributions from the government, employers and employees. As a result of KiwiSaver many New Zealand retirees will have access to the accumulated private retirement funds. However due to the

¹⁵ New Zealand Inland Revenue Department, 'Briefing for the Incoming Minister of Revenue—2014: The New Zealand Tax System and How it Compares Internationally' (Inland Revenue Department, 2014) 11 <<http://www.ird.govt.nz/resources/8/d/8d8ea8f9-53fe-4934-87c5-9094338af754/bim-2014.pdf>>.

¹⁶ OECD, above n 6.

¹⁷ *Goods and Services Tax Act 1985* s°14 specifies exempt supplies. From 2016 digital supplies of services will not also be subject to GST. Previously this had been one area that was not covered. However, this extension does not include the supply of goods online which would bring in a greater amount of GST.

¹⁸ Stephenson, above n 13, 14.

¹⁹ Ministry of Social Development, 'New Zealand Superannuation' (New Zealand Government) <<http://www.workandincome.govt.nz/products/a-z-benefits/nz-superannuation.html>>.

²⁰ Ibid.

²¹ *KiwiSaver Act 2006* (NZ).

²² Ibid, s°3.

relatively recent introduction of the scheme only modest returns will be available for several decades. This means that retirees will still have to rely principally on government support.

3.5 FTT as a solution to an aging population

For the purposes of this literature review, a FTT will be considered as a tax levied on the wholesale capital market secondary transactions.²³ The concept of FTT was developed by John Maynard Keynes in 1936 and James Tobin in 1972, and was considered a tax that would have both the benefit of raising taxation revenue, as well as reducing the negative externalities of the transactions they were imposed upon.²⁴ Tobin specifically considered a tax on international foreign exchange transactions and stated that it would be a ‘soft’ control on a system which as a result would deliver great benefit. Tobin continued to advocate for a ‘uniform worldwide tax on spot transactions across currencies’ which he observed was rediscovered by different groups from time to time.²⁵

Broadly there are two factors in support of a ‘Tobin’ tax. The first is the concept of supporting international agencies as argued in Tobin’s original concept advocated in 1972 at the Eliot Janeway Lectures. The second is recognition of the power of revenue generation as reviewed by Tobin in 1996.²⁶ Critics of Tobin’s approach have argued that currency-based transactions will be moved offshore to avoid the tax and make it less effective.²⁷ However, the need for a Tobin-type tax on international currency exchange is linked to concerns about international finance. These concerns have only increased in light of the Global Financial Crisis (GFC) and continuing concerns about the need to put ‘sand in the wheels of international finance’.²⁸ The potential revenue estimate from a global FTT of 0.05 per cent is US\$500 billion per annum.²⁹ In theory, the imposition of FTT would also see financial institutions contribute to the societies in which they operate. The concerns about international finance relate mainly to speculative behaviour and its potentially detrimental effect on global economies.³⁰ A quantitative country-specific study has also confirmed the link between currency fluctuations and a lack of control over currency-related

²³ Ross P Buckley, ‘Introducing a 0.05% Financial Transactions Tax as an Instrument of Global Justice and Market Efficiency’ (2014) 4(1) *Asian Journal of International Law* 153, DOI: 10.1017/S2044251313000271.

²⁴ John M Keynes, *The General Theory of Employment, Interest and Money* (Cambridge University Press, 1936); James Tobin, *The New Economics One Decade Older. Eliot Janeway Lectures 1972* (Princeton University Press, 1974).

²⁵ James Tobin, ‘A Currency Transactions Tax, Why and How’ (1996) 7 *Open Economies Review* 493, 493

²⁶ *Ibid*, 497.

²⁷ Nissanke, M ‘Revenue Potential of the Currency Transaction Tax for Development Finance: A Critical Appraisal’ (WIDER Discussion Paper No. 2003/81, World Institute for Development Economics, 2003).

²⁸ Barry Eichengreen, James Tobin, and Charles Wyplosz ‘Two Cases for Sand in the Wheels of International Finance’ (1996) 105(428) *The Economic Journal* 162, 162.

²⁹ Stephan Schulmeister, ‘Boom-Bust Cycles and Trading Practices in Asset Markets, the Real Economy and the Effects of a Financial Transactions Tax’ (2010) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1705628>.

³⁰ Rameshwar Tandon and Mohd. Shariq, ‘Global Capital Flows and Payment Imbalances’ in Ambar Nath Ghosh and K Asim Karmakar, (eds) *Analytical Issues in Trade, Development and Finance: Essays in Honour of Biswajit Chatterjee* (Springer India, 2014).

transactions.³¹ Another counter currency speculation option includes maintaining a low interest rate to remove incentives for speculators.³² The literature has responded to the Tobin tax proposal over time so that in its current context, post GFC, the anti-speculation aspects of a Tobin-type tax are the most important. It can be argued that in a similar manner a FTT would be a tax that can also reduce speculative behaviour in capital market transactions.

3.6 Factors influencing a FTT in Europe

While the section above considered the broader context of a FTT by focusing on the Tobin tax example, this section will review the implementation efforts of a FTT in the European Union. The European Commission has considered the implementation of a FTT and published documents relating to the implementation on its public website.³³ The European Commission has extensively emphasised the importance of renewing the economic and social contract between financial institutions and the society in which they operate and whom they serve.³⁴ In 2010 a Special Communication was released by the European Commission proposing the implementation of a FTT.³⁵ It conceded that regulatory reforms are essential to stabilise the financial sector, which benefitted from government support through the GFC, and it should 'make a fair contribution in return'.³⁶ FTT is also referred to as the 'Robin Hood tax', which will allow governments to take from the financial institutions and give it to the poor through welfare benefits and support.³⁷ The original proposal put forward on 28 September 2011 was not carried through because of lack of support.³⁸ On 22 January 2013 the Council of the European Union approved the adoption of a FTT for those states who wanted to continue with a FTT proposal on cooperative grounds.³⁹ The legality of this decision was challenged by the United Kingdom.⁴⁰ However, the process for establishing the tax, rather than the tax per se was challenged. With the United Kingdom exiting the European Union it is assumed that the challenge to the process for establishing a FTT will be mitigated.

³¹ Shakill Hassan, 'Speculative Capital Flows, Exchange Rate Volatility and Monetary Policy: South African Experience' (2015) *Contemporary Issues in Development Economics* 136.

³² Ibid.

³³ European Commission, 'Taxation and Customs Union', <http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.html>.

³⁴ Ibid.

³⁵ European Commission, 'Communication From The Commission To The European Parliament, The Council, The European Economic And Social Committee And The Committee Of The Regions Taxation of The Financial Sector {Sec(2010) 1166}' (European Commission, 2010).

³⁶ Ibid, 3.

³⁷ Buckley, R. (2011), 'Don't laugh this tax could fix the world', *The Conversation*, <http://theconversation.com/dont-laugh-this-tax-could-fix-the-world-772>. RHTO Robin Hood Tax Organisation, *How it works* <<http://www.robinhoodtax.org/how-it-works> on 26/11/2014>.

³⁸ European Commission, 'Financial Transaction Tax: Making The Financial Sector Pay Its Fair Share'. (Press Release, 28 September 2011) <http://europa.eu/rapid/press-release_IP-11-1085_en.htm?locale=en>.

³⁹ Council of the European Union, 'Financial transaction tax: Council Agrees to Enhanced Cooperation.' (Press Release, 22 January 2013) <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/134949.pdf>.

⁴⁰ *United Kingdom of Great Britain and Northern Ireland v Council of the European Union* (Case C-209/13) 2013 European Court of Justice.

3.7 Capital markets

Moderating the impact of capital markets in global finance is a feature of the Tobin tax discussed above. In terms of a FTT, the financial markets has also been considered in the literature. Tobin tax on currency, securities transaction taxes and FTTs are at times used interchangeably in the literature on taxing capital market transactions.⁴¹ The difference between each tax is its design and implementation. Each category of tax is linked through the concept that the financial transactions are taxed in some manner which affects trading activity and raises revenue. Technological improvements have increased financial transaction volumes and changed how transactions are implemented.⁴² Complex algorithms, high-frequency trading and computer-generated activity have enabled financial transactions on a large scale. These technologies are a primary factor facilitating large volumes of trades and algorithmic or computer-driven trading accounts.⁴³ These technologies work on predetermined rules to deliver specific outcomes and therefore are not driven by any underlying economic incentive other than short-term gains.⁴⁴ An ever-increasing proportion of market trades are short-term and technically driven by instruments such as derivatives, stocks, bonds and foreign exchange currencies. However, despite large trading volumes the true economic value of the capital markets has come under criticism.⁴⁵ Darvas and von Weizsäcker propose that the intentions of traders and institutes are unclear, and their actions leave to question whether the financial transactions are grounded in sound incentives and deliver economic efficiency, or whether they are merely measures entrenched in short-termism.⁴⁶

4. IS A FTT APPROPRIATE FOR NEW ZEALAND?

4.1 The New Zealand capital markets

The previous sections have identified that New Zealand has an issue with supporting its future ageing population. The existing government schemes to address this issue include encouraging individuals to save for their retirement through government-funded schemes. However, the sections above also identified that New Zealand faces a twofold problem with an ageing population because there is both an increased demand for social services and a decrease in tax revenue from income earners as they retire. Hence the possibility of introducing a FTT is one that should be considered particularly with the potential of a FTT to raise greater amounts of tax revenue. As a FTT is a tax on the financial transactions of an economy associated with shares, bonds

⁴¹ Karl Habermeier and Andrei A Kirilenko, 'Securities Transaction Taxes and Financial Markets' (2003) 50(1) *IMF Economic Review* 165.

⁴² Harald Hau, 'The Role of Transaction Costs for Financial Volatility: Evidence From the Paris Bourse' (2006) 4(4) *Journal of the European Economic Association* 862.

⁴³ Tom C W Lin, 'The New Financial Industry' (2014) 65 *Alabama Law Review* 567
<<http://ssrn.com/abstract=2417988>>.

⁴⁴ Frank J Fabozzi, Sergio M Focardi and Caroline Jonas, 'High-Frequency Trading: Methodologies and Market Impact' (2011) 19(7) *Revenue Futures Markets* 9.

⁴⁵ Stephan Schulmeister, Margit Schratzenstaller, Oliver Picek, 'A General Financial Transaction Tax: Motives, Revenues, Feasibility and Effects' (Austrian Institute of Economic Research, 2008)
<http://www.wifo.ac.at/jart/prj3/wifo/resources/person_dokument/person_dokument.jart?publikationsid=31819&mime_type=application/pdf>.

⁴⁶ Zsolt Darvas and Jakob von Weizsäcker, 'Financial-Transaction Tax: Small is Beautiful', (2011) 33(3) *Society and Economy* 449, DOI: 10.1556/SocEc.33.2011.3.2.

and derivatives; the need to evaluate the current position of New Zealand's capital market is relevant. The New Zealand Stock Exchange (NZX) is a listed company that builds and operates capital, risk and commodity markets in New Zealand. In June 2016 it had a total of 177 listed instruments and a combined market capitalisation of \$118 billion.⁴⁷ There are many other transactions and organisations that could be captured by a FTT including banks, investment firms and hedge funds operators. The size of the market and the potential revenue that can be raised is beyond the explorative scope of this study. However, other than its ability to raise revenues, the literature reveals various other advantages and disadvantages associated with FTT.

4.2 Advantages

A practical benefit in the implementation of a FTT is that the collection cost is generally low due to the electronic nature of the transactions. The United Kingdom's collection of various stamp duties provides an example of the cost effectiveness of collecting FTT.⁴⁸ According to the United Kingdom's Revenue and Customs in 2008 to 2009 the average collection cost for United Kingdom stamp duties was approximately 0.21 pence per pound raised, whereas the average collection cost for all taxes in the United Kingdom was approximately 1.10 pence per pound. Further to this, the collection cost for stamp duty (or similar taxation methods) on share transactions is likely to be substantially lower because stamp duties also include property taxes, which are typically more expensive to collect.⁴⁹ The success of the United Kingdom stamp duty is that it buys legal certainty. Buckley observes that it works in a way that inoculates the geographic relocation of transactions by charging only transferring ownership when it has officially been stamped.⁵⁰ Although it is possible to sell the share to a counterparty abroad and subsequently trade it thereby making it exempt from the United Kingdom stamp duty, the United Kingdom government charges a stamp duty at three times the normal rate, which reduces the likelihood to exit the system.⁵¹ The success of the United Kingdom system illustrates the collection of a FTT can be cost-effective.⁵²

Another advantage of an FTT is that it can limit some of the socially undesirable transactions which increase the systematic risk of the financial system.⁵³ In other words, a FTT can reduce speculative behaviour. For example, financial trades may be speculative with limited consideration of the underlying value of the economic assets on which they are made.⁵⁴ The effect of speculative transactions have a tendency to be negative rather than neutral. Speculative behaviour affected financial markets in

⁴⁷ New Zealand Stock Exchange, *Markets* (16 June 2016) <<https://www.nzx.com/markets/NZSX>>.

⁴⁸ HM Revenue & Customs, 'Meeting Our Challenges. Departmental Autumn Performance Report 2009' <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/228592/7774.pdf>.

⁴⁹ Steve Bond, Mike Hawkins and Alexander Klemm, 'Stamp Duty on Shares and its Effect on Share Prices' (Working Paper WP04/11, Institute for Fiscal Studies, 2004) <<http://www.ifs.org.uk/wps/wp0411.pdf>>.

⁵⁰ Buckley, above n 23.

⁵¹ Buckley, above n 23.

⁵² Stijn Claessens, Michael Keen and Ceyla Pazarbasioglu, 'Financial Sector Taxation: The IMF's Report to the G-20 and Background Material' (International Monetary Fund, 2010).

⁵³ Ross P Buckley and Gill North, 'A Fundamental Re-examination of Efficiency in Capital Markets in Light of the Global Financial Crisis' (2010) 33 *University of New South Wales Law Journal* 714.

⁵⁴ Schulmeister, above n 29.

the years leading up to the GFC in 2008.⁵⁵ A FTT will simplify financial transactions and consequently enable securities regulators to perform their job better and ultimately improve investor confidence. A core lesson from the GFC was that transactions have become overly complex resulting in a lack of understandable disclosures.⁵⁶ As Buckley and Arner observe, investors bought investments that they did not fully understand, with their investment choices based on ratings, the reputation of the investment bank and the advice of accounting firms. Better informed investing is likely to lead to a stronger, more accurately priced financial market and will also likely lead to more long-term investment rather than short-term allocations of funds.⁵⁷

The United Nations has noted an apprehension that the financial sectors of many developed nations have grown too large and consuming too much of a nations' human and financial capital.⁵⁸ The financial services industry has become attractive to the best-educated individuals in countries and, consequently, their abilities are used to trade virtual assets in a financial sector rather than creating tangible assets.⁵⁹ An advantage of a FTT is that it will tend to mitigate the short-term growth in the financial sector and instead may see more focus on the productive capacity of an economy.⁶⁰

4.3 Disadvantages

Despite the advantages as discussed above, the institutionalisation of a FTT has come under great scrutiny. One objection is that the potential impact of a FTT on global financial markets is difficult to quantify. Darvas and Weizsäcker observe that the lack of quantification brings into doubt the claims of increased tax revenue through a FTT.⁶¹ Also, complex transactions that are made up of a series of related, conditional transfers will be charged a FTT a number of times and as a result is likely to dissuade a substantial proportion of financial transactions. For this reason, alternatives such as bank levies or financial activities taxes, which are easier to quantify in a more predictable in terms of raising greater revenue. On the other hand, Darvas and Weizsäcker accept that if a FTT is imposed to reduce speculation then it does have some benefit in reducing short-term speculative trading.

Another drawback of a FTT is the potential to increase the trading costs of transactions in the financial market. The imposition of a FTT increases the cost per

⁵⁵ Gordon Menzies, Ron Bird, Peter Dixon and Maureen Rimmer, 'The Economic Costs of US Stock Mispricing' (2010) 33(4) *Journal of Policy Modelling* 552, DOI:10.1016/j.jpolmod.2010.10.010.

⁵⁶ Ross Buckley and David Arner, *From Crisis To Crisis: The Global Financial System and Regulatory Failure* (Kluwer Law International, 2011).

⁵⁷ Luigi Zingales, 'A Tax on Short-term Debt Would Stabilise the System' *Financial Times* (online), December 17, 2009 <http://faculty.chicagobooth.edu/luigi.zingales/papers/editorials/a_tax_on_short-term_debt_would_stabilize_the_system.pdf>.

⁵⁸ United Nations, 'Report of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System' (2009) <http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf>.

⁵⁹ Margaret M Blaire, 'Financial Innovation and the Distribution of Wealth and Income' (Research Paper No. 10–22, Vanderbilt University Law School. 2010) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1656451>.

⁶⁰ Dean Baker, *The Benefits of a Financial Transaction Tax* (Center for Economic and Policy Research, 2008)

<<http://cepr.net/publications/reports/the-benefits-of-a-financial-transactions-tax>>.

⁶¹ Darvas and Weizsäcker, above n 46.

transaction and as a result is likely to negatively impact the attractiveness of trading.⁶² Furthermore the reductions in trading volume will also likely result in a reduction in market liquidity; however, the degree of impact remains unclear. Buckley notes that if trading costs and bid-ask spreads are regarded as measures of efficiency, then under that definition a FTT would reduce efficiency.⁶³ However, if the measure of efficiency is so narrowly defined in where it focuses on individual transactions only, and not the allocative efficiency of the market overall, then its measure becomes rather uninformative for policy purposes. For perspective, if one considers the fact that high-frequency transactions cause prices to diverge from the indicative prices based on economic fundamentals, then it would be reasonable to state that the current financial markets are actually allocating resources relatively inefficiently.⁶⁴

It is also worth addressing the link between high-frequency transactions and speculation. High-frequency transactions that utilise speculation to allocate resources have been reported to make markets relatively more crisis-prone.⁶⁵ There is evidence that confirms that crisis damage impacts the long-term growth of financial markets far more than minor enhancements in trading costs⁶⁶. Therefore, although a FTT will marginally increase the cost of transactions, it can also decrease the long-term externalities caused by high-frequency transactions. From this perspective a FTT can actually be a means of long-term welfare enhancement.

As with any new tax regime, a key concern is where the burden of tax will fall. A FTT or the 'Robin Hood tax' is a tax that is supposed to take from the rich financial institutions, and used to provide social support to society. However, it has been argued that the burden of taxation is likely to fall entirely on the consumers who are investors or pensioners and not on the banks.⁶⁷ In response, the counter-argument is that a FTT which targets consumers would require the majority of these short-term trades to be initiated by pension fund managers.⁶⁸ Instead, evidence has shown that the majority of short-term trades are initiated by hedge funds and hedge fund-like proprietary traders working for banks rather than accounts targeted at clients. In this case a FTT would more likely impact the profits of hedge funds and banks rather than investors or pensioners. It appears that the taxation burden is far more likely to impact on the intended financial institutions. It should be noted that the New Zealand KiwiSaver institutional investors are likely to be affected by this tax, and as such it will be important for future research to study how this will affect investor perceptions as well as the profitability of the KiwiSaver scheme. On the other hand, the benefit they receive from more stable and long-term orientated markets will likely provide greater benefit than the imposition of tax.

Another key challenge in introducing a FTT is that there may be a lack of global reciprocity between nations implementing a FTT at a similar time. A problem with introducing new taxes is that institutions and individuals will find it relatively more

⁶² Ibid.

⁶³ Buckley and North, above n 53.

⁶⁴ Menzies et al, above n 55.

⁶⁵ Buckley, above n 23.

⁶⁶ Menzies et al, above n 55.

⁶⁷ Ralitsa Kovacheva, 'Pros and Cons of a European Tax on Financial Sector' *EUinside* (Online) 10 November 2011 <<http://www.euinside.eu/en/news/pros-and-cons-a-european-financial-transaction-tax>>.

⁶⁸ Neil McCulloch and Grazia Pacillo, 'The Tobin Tax: A Review of the Evidence' (Research Report No. 68, Institute of Development Studies, University of Sussex, 2011).

attractive to move their funds overseas to jurisdictions that impose relatively lower taxes.⁶⁹ For example, if a FTT was instituted in only limited jurisdictions, depending on the FTT rate, then traders could view FTT as a disincentive to trade in a particular country. For a FTT to achieve the objectives of raising revenue and reducing speculation it should be applied across major trading jurisdictions to limit incentives to switch trading focus to non-FTT jurisdictions. New Zealand would benefit more from an FTT tax if these other major trading jurisdictions, such as Australia, also implemented a FTT. Nonetheless, just as with the current United Kingdom stamp duty, a FTT does not need to be applied globally. A regional approach may also work effectively.

5. CONCLUSION

Overall, this paper provides an overview of FTT and highlights its value. The paper has also identified that the application of a FTT requires further research. Future research could focus on practical requirements for implementation of the tax within New Zealand. This includes research on the potential impact of a FTT on retirement funds that are held as part of the government-funded retirement KiwiSaver Scheme that operates in New Zealand. It is also recommended that future research is more empirical to ascertain the opinions of members potentially affected by this tax, which should include those working in the financial industry and investors. In terms of revenue gathering there is a need to assess the potential revenue that could be collected from the implementation of a FTT. Without an adequate measurement on the potential benefit of a FTT and a consideration of the potential economic impact on financial markets, the suggestion of immediate implementation of an FTT would be unsubstantiated. A FTT could be a powerful means of revenue generation and it may be effective in reducing speculative behaviour in capital markets. In the New Zealand context it is important to determine ‘why’ a FTT is needed or useful. A FTT could potentially address the concerns of how the government responds to increasing sources of tax revenue as the population ages. A FTT could potentially shift the reliance on tax revenue to another source of tax revenue, namely a FTT. However, if critics of a FTT are correct in suggesting that a FTT is limited in generating extra tax revenue then the other aspects of a FTT in reducing speculation should also be considered. It would be useful to research the implementation of a FTT at a regional level incorporating Australia. Overall this paper has provided a starting point for both the consideration and discussion of this topic and indicators for future research in this area.

⁶⁹ John Creedy and Norman Gemmell, ‘Can Fiscal Drag Pay for the Public Spending Effects of Population Ageing in New Zealand?’ (2014) 48(2) *New Zealand Economic Papers*, 183, DOI: 10.1080/00779954.2013.874394.