Assessing the economic impact of a financial transaction tax in Belgium

The European Commission has proposed a financial transaction tax (FTT). The purpose of this tax is to make sure that the financial sector bears a fair share of the burden of the financial crisis, and to discourage excessive risk-taking in the financial sector. The tax would apply to almost all financial transactions carried out by financial institutions established in the Member States.

In this article we explore whether the FTT is likely to correct the market failures that have contributed to the financial crisis, how well the FTT is likely to succeed in raising revenues, and how the FTT compares to alternative taxes in terms of efficiency. We find little evidence that the FTT will be effective in correcting market failures. Taxing of transactions is not well targeted at behaviour that leads to excessive risk and systemic risk creation. The empirical evidence does not suggest that the introduction of an FTT reduces volatility or asset price bubbles.

The FTT will likely raise significant revenues, in spite of the fact that the tax base is highly elastic. We find that the tax can potentially raise revenues up to 0.48% of the GDP for Belgium. When compared to alternative forms of taxation of the financial sector, the FTT is likely less efficient. In particular, taxes that more directly address existing distortions (such as the current VAT exemption for banks, and the bias towards debt financing) provide more efficient alternatives.

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