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Make state capitalism pay its way

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Transaction taxes would help the City pay back its cash debt to society – and now is the perfect time to introduce them

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The unpredictably unfolding global financial crisis is shaking the fundaments of the prevailing economic orthodoxy. Even though the newspaper headlines are currently focusing on the troubles of individual companies and political responses to their decline, Bears Stearns, HBOS and Lehmann Brothers cannot obscure the fact that there is a deep-seated systematic failure at the core of this crisis.

If the latest US government rescue package is passed by Congress, the Bush administration will have provided almost $1tn for the acquisition of bad debts and the bail-out of Freddie Mac, Fanny Mae and AIG alone. Even more unusual than this unprecedented state intervention in the financial markets was the upbeat reaction by Wall Street to one of the biggest nationalisation waves in US history – an unambiguous sign that the system has truly failed.

From a citizens' point of view, it is also quite clear what this extraordinary state intervention amounts to: after years of huge privatised profits and large bonuses rewarding short-term risk-taking, the losses and insecurities resulting from unsustainable business practices are now socialised with the taxpayer effectively taking over the risk. And there is little else governments can do as inaction would cause even bigger earthquakes in the financial sector and without a doubt have an even more disastrous impact on businesses and households. You simply have to keep the financial heartbeat going if you want to keep your economy in motion.

As a political reaction to the global financial meltdown, there is widespread agreement that the regulatory framework needs to be remodelled to prevent a similar disaster from happening again. It is a pity that the worst case had to materialise before sufficient political awareness could be created. But given the wide-ranging socialisation of financial risks, not just the rulebook but also the issue of taxation should be reconsidered.

If the taxpayer's money is used to secure the risks financial industries produced, financial institutions should vice versa contribute more than previously to the provision of public goods and welfare systems, which are there to insure individual citizens against life risks.

In the past, financial institutions have been particularly creative in avoiding adequate levels of taxation. Against the backdrop of the current situation, this needs to change. As taxation structures are very complex and dissimilar in different countries, the probably best – but still not easy – way to introduce a comprehensively applied new system of taxation would be the introduction of some form of transaction tax.

A Tobin tax in particular should be considered. Such a levy would tax currency conversions in foreign exchange markets and would thus set disincentives for short-term speculation. And given that the quickly rising daily turnover in these markets is currently $3.2tn, even a small tax rate of 0.05% could create revenues of about $400bn a year. This money could be partially used to fund badly needed international governance structures and – as indicated above – allocated to nation states to help insure individual citizens from life risks.

There are of course also major problems that make the implementation of a Tobin tax quite difficult. What exactly should the tax base be? What transactions would be taxable and at what rate? How exactly would the revenues be distributed? But regardless of these issues, the current political climate seems right to give this sort of taxation a new push. After all, on what basis could financial institutions complain about a low level of new taxation given the huge sums of money the ordinary taxpayer has to provide now to bail them out of their homemade crisis?

Civil society is the insurer of last resort for financial markets. A remodelled regulatory framework should acknowledge this fact and make sure that there is also a degree of responsibility in the opposite direction. A modest level of new taxation would ensure that financial institutions contribute to society more adequately during boom times and not only rely on the taxpayer to bail them out when they go bust.