Senior European Experts

A Possible EU Financial Transactions Tax

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Introduction

On 28 September 2011 the European Commission made a draft legislative proposal to the Council and the Parliament to create a financial transactions tax (FTT) in the EU with effect from 1 January 2014. The announcement of this proposal triggered a great deal of interest in the UK although the Commission had already announced its intention to do this and the European Parliament had endorsed the concept in April 2011. The concept of a global FTT has been under discussion in the G20 group of the world's largest economies since 2009 and a report of a group chaired by Bill Gates to the G20 advocated an FTT as a way to support the developing world.

In June and July 2012 the Council of Ministers debated the proposals but in the absence of unanimous agreement it was decided not to adopt it as an EU-wide tax. But 11 Member States who wanted to go ahead with an FTT in their own countries on a joint basis asked the European Commission to adopt the proposal under the enhanced co-operation procedure in the treaties; a new draft proposal has been published and is being considered by the Council and the Parliament.[1] If it were to be adopted the Member States agreeing to be part of the enhanced co-operation would apply the tax on transactions originating in their own countries.

This paper explains the Commission's original proposals and how the proposal for a more limited number of Member States to operate an FTT would work.

Background

The idea of a financial transactions tax has its origins the work of J M Keynes in the 1930s and that of Nobel prize-winning American economist James Tobin in the 1970s, both of whom were concerned about the level of risk in speculative financial transactions. Tobin argued for a tax on foreign exchange transactions because he saw such dealing as excessively risky and economically unproductive – hence the FTT is often called a "Tobin tax".

The idea of a general tax on financial transactions was revived during the global financial crisis. It was endorsed by Gordon Brown when Prime Minister in 2009. The G20 Toronto Summit in June 2010 communiqué said:

[1] The 11 Member States are: Estonia, France, Germany, Austria, Belgium, Greece, Italy, Portugal, Slovakia, Slovenia and Spain; see European Commission, *Proposal for a Council Decision authorising enhanced cooperation in the area of financial transaction tax*, COM (2012) 631 final/2, 25 October 2012

> We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or to fund resolution, and reduce risks from the financial system. We recognised that there are a range of policy approaches to this end. Some countries are pursuing a financial levy. Other countries are pursuing different approaches.[2]

The final part of the above paragraph reflected the fact that some countries – notably, the US, Canada and China – were opposed to an FTT but other countries were strongly in favour. France, Germany and several other European countries were particularly keen on an FTT as they blamed financial market speculation for the global financial crisis. The French Presidency of the G20 in 2011 ensured that the FTT idea remained under consideration as a potential global weapon to deter excessively risky and inherently unstable financial market speculation.

The European Commission's Proposals

Following a request by the European Council in October 2009 to consider the idea, the Commission brought forward a series of papers in 2010 and 2011 looking at aspects of an FTT. Supporters of the idea within the EU saw two potential benefits to an FFT: the first was greater stability in the financial markets because, although levied at a low rate, an FTT would act as a deterrent, it was argued, to some riskier transactions; and secondly that such a tax would raise additional revenue from those who had caused the global financial crisis, helping to pay back the €4.6 trillion cost of bailing out financial institutions. It is important to note that financial services, including insurance, are, unlike most other services, exempt from VAT in the EU and many financial transactions are not taxed at all; this exemption is worth €18 billion a year to the EU financial services sector.

The European Parliament asked the Commission to examine options for an FTT in a debate in March 2010 and the Commission held a consultation on such a proposal. The Commission's ideas were endorsed by the Parliament in April 2011 and published in detail two months later. In the mean time the Commission had identified a third reason for the EU to adopt an FTT; raising a contribution towards the EU's budget (see end of paper).

An EU FTT

The FTT proposed by the Commission for the EU would have been raised on approximately 85 per cent of financial transactions between businesses; financial services for individuals (e.g. loans or mortgages) or small businesses would not generally be covered. The Commission defined a "financial transaction" as applying to the "exchange of financial instruments between banks or other financial institutions", in other words, securities, bonds, shares and derivatives.

The tax would have been levied on all transactions between financial institutions, if at least one of them was deemed to be established in the European Union. As this would be a single market measure, all Member States would have had to levy the minimum rate of the tax. It would have been levied on both parties to a financial transaction and would have been collected electronically in most cases.

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[2] G20 Research Group, *The G-20 Toronto Summit Declaration*, 27 June 2010, para 21

The minimum rate proposed by the Commission was 0.1 per cent in respect of bonds and shares and 0.01 per cent for other transactions, including derivatives. The estimated tax take in one year if the tax had been levied at these rates was €57 billion.

Exemptions to the tax would include:

- most retail banking transactions;
- spot currency exchange transactions;
- issuing of bonds or shares on the primary market;
- raising of capital by enterprises or public bodies;
- central bank transactions.

Impact on financial services in EU Member States

The European Commission published a highly detailed impact assessment alongside its legislative proposals. The assessment looked at other options for taxing financial transactions and gave estimates of the likely consequences. It concluded that the GDP and employment consequences were likely to be small but negative in the case of an EU-wide FTT. The impact assessment suggested that the FTT would cost about 1.76 per cent of GDP but that the impact could be reduced to around 0.53 per cent of GDP with a number of mitigating factors. The reason for the negative consequences are that the cost of capital would increase as those who are taxed try to pass the tax on to their clients thus leading to a reduction in investment. There are of course considerable difficulties in modelling the impact of a new tax, particularly when its introduction may lead to significant changes in behaviour.

In terms of employment, the Commission gave a range of potential effects varying between -0.03 per cent and -0.20 per cent. Turning these figures in to numbers of jobs lost is hard as the trading of many of these products is concentrated in a small number of centres (including London) and it requires predicting market behaviour.

Three-quarters of financial transactions in the EU area take place in the UK so the City of London would have been significantly affected by the introduction of an EU-wide FTT, particularly if such a tax was not global. In those circumstances it would be relatively easy for other countries to evade an FTT by using bank branches in for example, Zurich or New York. The view of the British Bankers Association was that British banks were already paying towards the cost of the financial crisis through the UK bank levy and that anything less than a global FTT would not work. Critics of the proposal feared a permanent loss of trading within the EU because banks would shift their trading activities to the US and to Asia. But the UK is one of 10 Member States to already apply its own FTT – stamp duty – so the actual impact of an EU FTT might have been less than feared (although stamp duty is more limited in scope than the proposed FTT and applies to some retail transactions).[3]

Using an FTT to finance the EU

Since 1970 the EU has been partly funded by customs duties and levies on imports into the EU. But this source of revenue has fallen considerably in recent years (it is now about 12 per cent of the total), resulting in a greater reliance on contributions from VAT and from national

[3] States already applying an FTT: Belgium, Cyprus, France, Finland, Greece, Ireland, Italy, Romania, Poland and the United Kingdom

budgets, which has proved unpopular. In making its proposals for the next Multiannual Financial Framework (MFF), the Commission suggested that income from an FTT could replace or supplement income from Member States; this would give the EU once again a substantial income stream of its own resources. As the proposal for an EU-wide FTT has been dropped, this aspect of the original proposal is no longer relevant.

The Enhanced Co-operation Proposals

Under the treaties a group of nine or more Member States can proceed with a proposed policy using the institutions and procedures of the EU provided certain tests are met. The purpose of enhanced co-operation is to enable a group of Member States to proceed with a joint policy under the auspices of the EU in a way that does not disadvantage those Member States who do not wish to participate.

In October 2012 the Commission published its decision on the proposal that an FTT be adopted through the enhanced co-operation procedure. The Commission concluded that the proposal met the necessary tests under the Treaties. That is, the Commission believes that an FTT operated by a group of Member States working together would not adversely affect the interests of Member States who did not join, it would not harm the Single Market (but would in fact enhance it through a reduction in barriers to trade) and it would further EU objectives by reducing market distortions and opportunities for tax evasion.

The enhanced co-operation proposal assumes the core elements of the original proposal would be applied by those Member States who chose to participate. It is hard at this stage to assess what impact an FTT adopted by a limited number of EU Member States would have on financial services in those countries and in the Member States that would be outside of such an arrangement. The Commission has said that the details of their original proposals might have to be altered for the FTT to work on an enhanced co-operation basis.

The procedure has two stages: the Council and the Parliament must agree on whether enhanced co-operation can go ahead and then Council Members of the countries adopting the new FTT would have to agree the detailed legislation. The Commission had hoped that the Council of Ministers would rapidly reach agreement on the first stage but several Member States not choosing to participate in the enhanced co-operation said at the November 2012 Economic & Financial Council that they wanted further examination of the potential impact on the Single Market before the proposal was decided.

So far there is a lack of clarity about a key question – whether such an FTT would apply to transactions that originated in one of the enhanced co-operation states that was applying it (*e.g.* Germany) and involved another Member State outside of the FTT (*e.g.* the UK); this is known as extraterritoriality. How the UK votes on the enhanced co-operation proposal may well be determined by this aspect. Countries outside the EU (*e.g.* the USA) may also have strong views about the effects of extraterritoriality.

In any event, the enhanced co-operation proposals will need the support of the European Parliament and of the Council and then agreement amongst the Member States choosing to participate before the financial transactions tax could be introduced in those countries.

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Senior European Experts

The Senior European Experts Group is an independent body consisting of former high-ranking British diplomats and civil servants, including several former UK ambassadors to the EU, and former officials of the institutions of the EU.

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