An appraisal of uk’s opposition to the proposed eu ftt

Finance

Introduction

The European financial transaction tax (FTT) is a proposal by the European Commission expected to be introduced in 2014, covering the 27 states, member of the EU. This tax is intended to cover financial transactions between financial institutions, with proposed charges against exchange of shares and bonds, and derivative contracts.[1] The tax is expected to raise 57 billion Euros a year if implemented and its intended use is tofinancethe European Union reducing its dependence on member state contributions, as well as, to shield the market from financial crisis. It is, however, raising controversy among EU member states, with particular opposition from the UK government citing negative impacts of the tax.[2]

The scope for this proposed tax is transactions on financial instruments undertaken with at least one financial institution party to the transaction established within the territory of a member state of the EU, no matter the venue of the transaction. It is intended to cover 85% of transactions between banks, insurance companies, investment firms, pension funds, hedge funds, among others, but, exempts mortgages on housing; insurance contract contributions; spot market currency exchanges; bond and share issues for capital fundraising; and, bank loans to small and medium enterprises and individuals.[3] This implies that transactions by citizens and businesses are not a target for this tax though trading of bonds on secondary markets is subject to the tax. Also exempted are transactions with central banks nationally or with the European Central Bank.

Each party in a taxable transaction will pay their share of the tax to the EU member state where they are established, charged through reference to the time of transaction and levied on the provided price or value of consideration or on a notional amount (for a derivatives contract). It has been formulated with a deliberate breadth of coverage to prevent avoidance through complex financial substitution of products by institutions.[4]

One of the functions of the proposed tax is the harmonization and establishment of standards for similar taxation provisions running at national level, complementing existing measures and providing consistency across the region.[5] The financial crisis with its associated impact on finances of governments has brought about intensified debate with regard to the use of taxation measures as a means to mitigate the effects of excess risk-taking on financial institutions or in endeavors to ensure that the financial sector contributes substantially to public finance. An example is the UK which, in response to public reaction over bail-outs that banks received in the financial crisis, has implemented taxation which include; a bank levy based on judgments of balance sheets, with liabilities owned weighted against risk thereby imposing greater taxation for higher risk and speculative activities; and, a traditional stamp duty reserve tax with a 0. 5% levy imposed on UK share transactions (though covering a narrow transaction range unlike those proposed by the commission.[6]

The feasibility of this proposed tax is dependent largely upon the agreement between all the 27 member states of the EU through ongoing discussions. The finance ministers of France, Germany, Spain, Belgium, and Finland have spoken in favor of the financial tax proposals, while Austria and Spain are also known to be in support of the proposals. However, some nations strongly oppose the proposal including the United Kingdom, Sweden, the Czech Republic, and Bulgaria, while some openly express reservations including; the Netherlands, Italy, Ireland and Finland.[7] There is, therefore, a significant divergence of opinion between EU member states.

Criticisms of the proposal are; that it could be detrimental to the financial sector; and, that the taxation of individual transactions is less effective in taxation compared to the balance sheet levy system as currently employed in the UK, which could be more effective. This concern is premised on the notion that the additional revenue raised could be offset by possible effects on the financial sector that could be negative with potential costs to GDP growth and that taxation of individual transactions bring forth unintended consequences hindering liquidity and thereby challenging the recovery of European economies from effects of the recent financial crisis.[8] A tax of the type proposed would likely result in a decrease of trade volumes, notably, the high frequency trading, with the additional cost to every transaction eating into profits. The proposed tax would make hedging and risk-management more expensive to engage in for institutions, though they are deemed to be essential for economic growth in the long-term.[9]

The difficulty in the administration of tax for single transactions, comparative to the year-end balance sheet approach, is also of concern along with the belief that its implementation without similar provisions for global financial institutions would be a competitive disadvantage for financial institutions in the EU. A cause for more negative sentiment is the lack of clarity over tangible benefits to the rest of society for the revenues accrued. This is backed by the idea that the revenue could be designated as EU’s own resources, spent “ as of right”, not as with current arrangements where member governments make contributions begrudgingly.[10] Therefore, it is considered an undeserved benefit for the EU bureaucracy.

Officials from the city of London have expressed concern as well, that up to 80% of the financial transaction tax revenues could come from London-based transactions with players in the market threatening a move of operations away from Europe if the tax were to be implemented.[11] The UK treasury is also strongly resisting such proposals if its implementation is not global, with inquiries launched to investigate impact and effectiveness.

Propositions

Proponents of the FTT argue that it would make the distribution of the tax burden fairer enhancing both stability in the financial sector and revenues. They argue that all taxes when observed in isolation tend to carry some economic cost, but the urgency for revenue and the consideration that it would lower the billions of dollars paid as bail-outs in support of the financial sector, carries with it positive weight for the implementation of the FTT.[12] Looking at its potential and intent in discouraging forms of high risk trading and therefore preventing future crises makes for a significant positive argument for the implementation of the FTT. Such a measure would be beneficial in light of recent cries globally and particularly in Europe.[13] The most significant threat to UK’s growth in the long term is not the proposed tax, but an uncontrollable financial sector. The Bank of England has found the cost that the financial crisis will have to the UK economy will be ? 1. 8 trillion in the least, and could be as much as ? 7. 4 trillion. The lower value of the cost is equivalent to more than a year's output and therefore, controls on the financial sector through a FTT might be welcome.[14]

Stephany Griffith-Jones and Avinash Persaud in a recent study examine impacts of FTT, notably the decrease in the probability of crises of the economic kind.[15] They say the introduction of a FTT would, in fact, have a positive impact on GDP, by at least 0. 25%. This means that its effect on GDP could be higher especially is the FTT revenues are used progressively to encourage investment and sustain growth, while creating avenues for employment.

If the projected revenue is utilized to consolidate national budgets of member states, resulting in the reduction of other taxes or enhancing investments, its direct effect would be a growth in the economy with possible reduction in unemployment. This argument, also, dispels the notion that the tax would be an underhand way of increasing the budget for the EU. A large part of the revenue in the proposal would go directly to the member states with the bit meant for the EU serving to offset reductions in national contributions.[16] Both France and Germany, who are key proponents to these proposals, are however against the use of FTT revenue to fund the EU. With discussions regarding the sharing of revenue between the EU and national governments, most revenue will most likely go to the latter.[17]

Also dispelled is the argument that citizens and businesses would bear the burden eventually, even though it may not be the intention of the proposals. Proponents argue that, even if the financial sector were to pass on some of the costs to its clients, the outcome would not be disproportionate as to cause a significant dent on finances and thereby qualify as a burden. The positive effects of an FTT overall would far outweigh this particular argument and, with ordinary citizens facing higher taxes on their incomes, as well as on their consumption, i. e., foodand fuel, and the public sector facing cuts, it is reasonable to expect payment of a fair share by the financial sector, and the financial tax proposes such a measure.[18] Austerity measures initiated might not adequately undo the crisis. Support for this is needed and revenues to fill up deficits as well as measures to bolster growth and to focus on employment are measures that could have this desired impact. The customers of these financial institutions, engaged in these financial transactions (trading in share, bonds and derivatives) are most often of high net-worth alongside financial institutions. The FTT would as such fall onto the higher, rich segment of the economy and society, a boost to ongoing austerity measures. This is unlike VAT which is disproportionate, falling on the poorer segments of society.[19]

Theanxietyover its effect on the city of London is considered to have a flimsy basis as the financial sector is vital for the single European market. It is in the interest of the EU for the city to retain its strength and stability, key to the region’s dominance of the global financial sector.[20] There are measures in the proposal preventing the relocation of operators and players in the financial sector such as the “ residence principle”, which makes relocation unfavorable as it does not focus on the location of the transactions but the parties engaged. As long as one or both parties are established in the EU, they would be liable to pay the financial transaction tax. If banks and the players in the sector would want to avoid the tax measure, they would have to abandon their clients in the EU altogether, a huge price to pay for a 0. 1% tax on shares and bonds and a 0. 001% tax on derivatives.[21] The UK’s tax on its share transactions (Stamp Duty) is a clear example of effect of taxes on businesses. It raises approximately 3 billion pounds for the country’s finance ministry every year but has not led to a significant loss of business from the UK.[22]

The argument that the FTT need be global is challenged by International Monetary Fund reports showing that more than 40 countries in the world have unilateral FTTs, and their success challenges claims that it won’t work unless on a global scale and that it might lead to an exodus of players in the sector. Among the countries that have FTTs are Brazil, India, USA, South Korea and South Africa, as well as ten member states of the EU.[23] A one-off tax at 0. 1%would unlikely figure highly in long term decision-making by investors. To reduce tendencies for avoidance, the taxes should be relatively modest and spread across many instruments as possible preventing possibility for substitution.

Conclusion

The United Kingdom should drop its opposition to the proposed European Union Financial Transaction Tax (EU FTT) as the potential benefits that could be accrued from such a tax far outweigh the perceived drawbacks. Most of the criticisms for the proposals that have emerged, as has been illustrated, can be reasonably countered with acceptable arguments. Studies like that of Stephany Griffith-Jones and Avinash Persaud, the European Commission, the IMF and other interested parties are useful in countering some of the criticisms which, in some cases, are not evidence-backed but are sentimental opinions and products of a narrow view.

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