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The Financial Transactions Tax as Tax-based Own Resource for the EU Budget

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Key Findings

- A broad-based financial transactions tax presents itself as a suitable instrument to simultaneously raise revenues and curb highly speculative and potentially destabilising short-term financial transactions.
- The introduction of an FTT within Enhanced Cooperation in the EU may serve as a pilot, representing the first step towards an EU-wide implementation.
- Under a Brexit scenario, an FTT introduced by a “Coalition of the Willing” including 10 EU Member States could yield €4 to €33 billion.
- The FTT is an interesting option for tax-based own resources partially substituting current own resources to finance the EU budget, allowing Member States to cut their national contributions to the EU budget and thus creating budgetary space to cut national taxes more harmful for growth and employment (in particular the high taxes on labour).
Introduction
The debate on the introduction of a financial transactions tax (FTT) has been led for decades now. Beginning with Keynes (1936), who suggested a tax on transactions on stock markets after the Great Recession, a number of concepts for the taxation of (certain) financial transactions were brought into discussion. After the breakdown of the Bretton Woods System in the beginning of the 1970ies and the currency crises in Russia and Asia in the 1990ies, the focus was initially on the taxation of currency transactions, as suggested by James Tobin (1978). With the introduction of the common currency in an increasing number of EU Member States the idea of taxing currency transactions has lost much of its relevance in the European context. During the last decade the focus of the academic as well as the policy debate has shifted towards a general FTT levying a uniform tax rate on all financial transactions. The recent financial crisis resulted in new momentum for this concept of a general FTT, also against the background of the general under-taxation of the financial sector (Cannas et al. 2014).

The concept of a general financial transactions tax
Compared to specific transaction taxes taxing certain financial transactions only, a broad-based general FTT has several advantages (Schulmeister, Schratzenstaller and Picek 2008):

- The taxation of all financial transactions would render avoidance reactions away from taxed to non-taxed transactions impossible.
- Due to the very broad tax base also a low tax rate would result in significant tax revenues.
- Even such a low tax rate would suffice render very short-term speculative and potentially destabilising transactions unprofitable and would thus reduce them to a large extent. At the same time, a low tax rate would hardly affect long-term oriented transactions to finance real activities, as for example currency transactions financing foreign direct investment or the long-term investments of pension funds.

In the last few years a number of empirical analyses of the effects of FTTs on liquidity, volatility, and trading volume on the taxed markets as well as on capital costs were published. A recent literature survey by Hemmelgarn et al. (2015) shows a mixed picture and illustrates that the actual impact of an FTT crucially depends on its design. Of course it must be noted that the existing empirical evidence is based on pure national experiences, allowing to a rather limited extent only any predictions about the enforceability and the effects of an internationally coordinated FTT introduced on a harmonised and very broad tax base in a larger group of countries.
Existing national financial transactions taxes in the EU

Currently financial transactions are taxed in 10 EU Member States (Solilová, Nerudová and Dobranschi 2017). Essentially these national FTTs are levied on certain security transactions on stock exchanges (in the form of a stock exchange transaction tax) or off markets. Tax rates range between 0.01 percent and 5 percent; revenues in terms of GDP are rather modest, ranging between 0.03 to 0.04 percent (Italy and France) and 0.74 percent to 0.89 percent (United Kingdom and Malta). Particularly interesting cases are France and Italy: both countries abolished their stock exchange taxes in 2008, but implemented (in 2012 and 2013, respectively) relatively broad-based national FTTs, inter alia explicitly targeting speculative transactions (derivatives and high frequency trade).

In many countries national FTTs have been criticised for causing competitive disadvantages in internationally integrated financial markets. Accordingly, 9 EU Member States have abolished their national stock exchange taxes since the end of the 1980s (Solilová, Nerudová and Dobranschi 2017); Italy and France as the last ones since the outbreak of the recent crisis in 2008. As already mentioned, both countries implemented a broader-based national FTT in 2012 and 2013, respectively, inter alia to impart a new momentum to the discussion about the introduction of a financial transactions tax at EU level (Schäfer 2015; Hemmelgarn et al. 2015).

Initiatives aiming at the introduction on an EU-wide financial transactions tax

After the failure of an agreement on the G20 level about the internationally coordinated introduction of an FTT, the European Commission started to examine various options to tax the financial sector in 2010 (European Commission 2010). Their proposal of an EU-wide broad-based general FTT put forward in 2011 envisaged the introduction of minimum tax rates as of 2014: 0.1 percent on stock and security transactions and 0.01 percent on transactions with stock and security derivatives. Currency transactions on the spot market and other transactions with derivatives as well as typical financial transactions of small savers, like loans, mortgages, insurance contracts and credit card transactions, were supposed to remain untaxed (Hemmelgarn et al. 2015); the tax should affect banks, insurance companies, funds and hedge funds. The potential revenues were estimated at € 57 billion for the case of EU-wide implementation. Besides stabilising the financial sector, a further argument put forward by the European Commission in favour of the FTT was that it would secure an adequate contribution of the financial
institutions to the recovery of the crisis costs. Moreover it would result in a certain convergence of the national specific financial transaction taxes applied in a number of Member States and thus remove existing distortions on the European common market.

As the United Kingdom as well as Sweden, Bulgaria and the Czech Republic fiercely opposed this proposal, the unanimity required in tax matters could not be reached. The European Commission therefore in 2012 suggested the introduction of the FTT using the instrument of enhanced cooperation, which requires the participation of at least nine Member States. In the end of 2012, 11 Member States joined forces to advance the implementation of a financial transactions tax within the framework of enhanced cooperation. In the beginning of 2013 the European Commission released a slightly modified proposal which was expected to yield revenues between €30 billion and €35 billion (European Commission 2013). In May 2014 all participating countries with the exception of Slovenia agreed on a progressive tax on transactions with securities and selected derivatives, to be implemented in 2016. In the end of 2015, Estonia left the „Coalition of the Willing“ after several fruitless negotiation rounds.

Since then, even more negotiation rounds have taken place, the most recent one in mid-September, 2017, in Tallinn (Estonia). Here it was agreed that experts from all countries participating in the “Coalition of the Willing” should clarify three points: First, the effects of the FTT on those countries with capital-funded pension systems should be determined. Secondly, the expected revenues and the implementation costs of the tax should be quantified. Thirdly, all possible scenarios and their effects in relation to the upcoming Brexit should be identified in cooperation with the European Commission. Simultaneously the European Commission was commissioned to present a draft directive to the Finance Ministers of the countries involved.

An EU-wide general financial transactions tax

There are hardly any other taxes demonstrating as clearly as an FTT the limits of an un-coordinated introduction on the national level. The limitation on security transactions in those countries still levying a financial transactions tax, and the observable long-term trend towards the elimination of such taxes are the result of the high international mobility of financial transactions, particularly of those with a derivative nature. Also the recent experiences of Italy and France with their national FTTs corroborate the limited effectiveness of a pure national taxation of financial transactions (Schäfer 2015).

1 Germany, France, Italy, Belgium, Austria, Spain, Greece, Portugal, Slovak Republic, Slovenia, Estonia.
The EU offers an adequate political, legal, economic and regional framework for the coordinated introduction of a broad-based financial transactions tax with a low tax rate. From an economic perspective there are several reasons for a coordinated implementation:

- If the FTT is introduced to internalise negative externalities, unilateral implementation will result in too low tax rates. The potentially destabilising effects of very speculative transactions are of a cross-border nature, which most likely will be ignored by national governments’ decisions about the tax rate.
- The considerable international mobility of large parts of the tax base bears the danger of a race to the bottom, if actors on financial markets evade to non-taxed financial markets. National governments are likely to end up in a prisoners’ dilemma: Each country would be better off with an FTT stabilising financial markets. Expected avoidance reactions, however, discourage national governments from unilateral implementation of FTTs.

Substantial revenues can be expected from EU-wide implementation. Crucial parameters for the estimation of potential revenues are the level of tax rates, the breadth of the tax base, and the elasticity of the taxed transactions. These parameters, and accordingly revenue estimations, differ in the existing studies. However, all existing estimations suggest a considerable revenue potential of an EU-wide FTT. As mentioned above, the European Commission estimates the revenues from an EU-wide financial transactions tax at € 57 billion. Solilová, Nerudová and Dobranschi (2017) estimate potential revenues for the EU28 of up to € 1.7 - 58.3 billion (based on Eurostat data for the period between 2012 and 2014). Introducing the FTT within enhanced cooperation among the Coalition of the initially 11 willing Member States would yield € 30 to 35 billion according to the European Commission (2013). For such a scenario, Schulmeister and Sokoll (2013) expect revenues of € 56 billion; Solilová, Nerudová and Dobranschi (2017) estimate up to € 0.5 - 20 billion (based on Eurostat data for the period between 2012 and 2014).

To estimate FTT revenues in case of Brexit, i.e. the United Kingdom leaving the EU and therefore its integrated capital market, Eurostat data cannot be used, as the data for the London Stock Exchange cannot be extracted. Therefore, to estimate FTT revenues for the remaining 10 Member States willing to implement the tax based on enhanced cooperation in a post-Brexit scenario, World Federation Exchange Data for the year 2016 are used. FTT revenues are estimated to range between about € 4 and € 33 billion (table 1), differentiating between three scenarios:

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2 For methodological details see Solilová, Nerudová and Dobranschi (2017).
• The “static scenario” neglects all potential market reactions initiated by implementing an FTT (i.e. tax evasion and relocation of transactions, increased transaction costs, and the effect of taxation on the transaction volume measured by an elasticity).

• The “maximum evasion scenario” assumes a 60 to 95% range for a tax evasion and relocation effect for derivatives and 5 to 25% for securities. It also considers other relevant variables such as transaction costs (based on empirical evidence in previous studies) and elasticities ranging from -2 to 2. This scenario is similar to the approach used by the European Commission (2011).

• The “no evasion scenario” assumes no tax evasion and relocation effects in the markets and is calculated by combining the different values of transaction costs and of elasticities analogous to the second scenario.

There are various proposals how to use FTT revenues. The initiative of the “Coalition of the “Willing” envisages channelling FTT revenues into national budgets to be used for fiscal consolidation and/or the reduction of other taxes. However, there are good arguments to use FTT revenues to finance a supra- or international body. Due to the cross-border nature of the taxed financial transactions and the use of the taxed financial centres also by non-resident actors, as well as of the potential negative externalities particularly of highly speculative financial transactions, revenues can hardly be assigned to individual Member States. Moreover, revenues are additional in the sense that they would not have been realised in the absence of international coordination. Such an international use of the revenues of an FTT is in accordance with the European Commission’s initial proposal to substitute a part of the EU’s current own resources to finance the EU budget by the revenues of a financial transactions tax. Therefore the FTT could be a suitable candidate for a reform of the EU system of own resources drawing on sustainability-oriented tax-based own resources (Schratzenstaller et al. 2017; Solilová, Nerudová and Dobranschi 2017). Such a reform would allow cutting national EU contributions so that EU Member States would gain budgetary space for the reduction of taxes which are harmful for growth and employment (in particular the high taxes on labour). For this reason the FTT is mentioned as one option for tax-based own resources also in the final report by the inter-institutional High Level Group on Own Resources coordinated by Mario Monti (HLGOR 2016) as well as the European Commission’s recent “Reflection Paper on the Future of EU Finances” (European Commission 2017).
**Table 1: Financial Transaction Tax Revenues under a Brexit Scenario in million EUR**

<table>
<thead>
<tr>
<th>Classification of Revenues*</th>
<th>Static scenario</th>
<th>Maximum evasion scenario</th>
<th>No evasion scenario</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>0.01% - derivatives&lt;br&gt;0.1% - equity&lt;br&gt;0.01% - OTC</td>
<td>0.01% - derivatives&lt;br&gt;0.1% - equity&lt;br&gt;0.01% - OTC</td>
<td>0.01% - derivatives&lt;br&gt;0.1% - equity&lt;br&gt;0.01% - OTC</td>
</tr>
<tr>
<td>AT</td>
<td>1 346.22</td>
<td>162.91</td>
<td>607.44</td>
</tr>
<tr>
<td>BE</td>
<td>2 479.38</td>
<td>279.68</td>
<td>1 130.38</td>
</tr>
<tr>
<td>FR</td>
<td>13 133.95</td>
<td>1 480.21</td>
<td>5 987.37</td>
</tr>
<tr>
<td>DE</td>
<td>10 007.75</td>
<td>1 303.11</td>
<td>4 633.73</td>
</tr>
<tr>
<td>EL</td>
<td>179.52</td>
<td>43.10</td>
<td>91.17</td>
</tr>
<tr>
<td>IT</td>
<td>2 792.88</td>
<td>472.42</td>
<td>1 337.52</td>
</tr>
<tr>
<td>PT</td>
<td>248.00</td>
<td>52.09</td>
<td>122.91</td>
</tr>
<tr>
<td>SI</td>
<td>29.06</td>
<td>8.93</td>
<td>15.55</td>
</tr>
<tr>
<td>SK</td>
<td>183.87</td>
<td>32.39</td>
<td>88.58</td>
</tr>
<tr>
<td>SE</td>
<td>2 406.18</td>
<td>269.24</td>
<td>1 096.11</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>32 806.81</strong></td>
<td><strong>4104.07</strong></td>
<td><strong>15 110.75</strong></td>
</tr>
</tbody>
</table>

*Results are presented as average values eliminating outliers (i.e. only the range between the 5th and the 75th percentile is considered).

Source: Own Calculations.
References


High Level Group on Own Resources - HLGOR (2016). Future Financing of the EU. Brussels: High Level Group on Own Resources.


