

Financial transaction tax

FTT less harmful to growth than announced, says study

By Tanguy Verhoosel | Tuesday 07 February 2012

A study commissioned by the European Parliament's Socialists and Democrats (S&D) group states that the economic impact of introducing a financial transaction tax (FTT) in the Union will be far less negative – at worst, a loss of 0.1% of GDP – than estimated by the European Commission.

The conclusions of the study carried out by economists Avinash Persaud (founding chair of Intelligence Capital and emeritus professor at Gresham College) and Stephany Griffith-Jones (financial markets director at The Initiative for Policy Dialogue at Columbia University), were presented on 6 February at the European Parliament. That same day, the Committee on Economic and Monetary Affairs (ECON) held a public hearing on the FTT chaired by rapporteur Anni Podimata (S&D, Greece).

In the impact study, presented in September 2011, the Commission estimates at 0.53% the long-term loss of GDP in the European Union as a result of the FTT, for which it proposed minimum rates of 0.1% on transactions on shares and bonds and 0.01% on derivatives transactions.

Revised model

Persaud and Griffith-Jones revised the model on which this estimate is based. They estimate that the negative impact of the tax should be no greater than 0.1% of GDP.

The tax could even have a positive impact – at least +0.25% of GDP – since the Commission failed to quantify its expected positive benefits in its impact study.

These include the reduction of systemic risks and the possibility to invest the tax proceeds (€57 billion a year, according to the Commission) in growth and job-enhancing projects in renewable energy, research, etc.

Long-term investors like pension funds and insurance companies will pay the least while short-term speculators like hedge funds and high-frequency traders (which account for 40% of total transactions, says Griffith-Jones) will pay the most.

Discouraging high-frequency trading

A high-frequency trader that turns over its entire portfolio in a day would pay a thousand times more than an average pension fund that buys and sells 50% of its portfolio over two years. The high-frequency trader will pay transaction taxes of 50% a year, while the pension fund will pay only 0.05%. High-frequency trading will therefore probably fall off dramatically in the EU, which is one of the FTT's key objectives: to discourage short-term speculation – which tends to absorb all available liquidities – and encourage long-term investments.

That still leaves a problem seen as crucial by the City, namely how to avoid massive relocations outside the EU of financial firms that wish to avoid the tax.

For Griffith-Jones, the risk is limited: "In the past, the same was said about income tax," but evasion is limited.

Combining two principles

The authors of the study also propose to improve the mechanism imagined by the Commission to keep capital flight to a minimum. It is based on the principle of residence: if one party has its head office in the EU, all transactions must be taxed, regardless of where they take place.

Griffith-Jones suggests combining this principle of the operator's residence with that of the issuer's residence, based on the British stamp tax model.

A stamp tax is paid by everyone – residents and non-residents, individuals and institutional investors – on every transfer of ownership of a security issued by the state or an institution in the state.

The stamp tax is nearly impossible to avoid. "A Chinese investor using a British bank in Hong Kong to buy a French security will still have to pay the tax, because otherwise he will not receive legal title to the security and could not receive any dividends" without taking a very high risk, notes the study.

So the conclusion is that the combination of two options would help minimise tax evasion, commented Podimata, who added that she would propose this solution in her report on the FTT, due to be finalised in mid-February.

Will the European Parliament succeed in convincing the many EU – and even eurozone – member states put off by the current FTT proposal? It is to be hoped so, because the different sides are growing more firmly entrenched in their positions.

The Hague stalls as Paris forges ahead

In any case, the central bank of the Netherlands (DNB) went on the offensive, on 6 February, saying the introduction of such a tax at European level was "undesirable". According to the DNB, the FTT is "not certain" to achieve its objectives. What is certain, on the other hand, is that its application will cost Dutch banks, pension funds and insurers €4 billion a year.

On the opposite side, French President Nicolas Sarkozy announced, on 29 January, that France would adopt, in August, a law setting up a financial transaction tax on its territory. According to information published on 6 February, its scope will nevertheless be much more restricted than what the Commission is considering (which has already sparked an angry reaction by Oxfam France, whose president commented that "what is proposed is not a tax on financial transactions but an endless list of exemptions, a real Swiss cheese"). Griffith-Jones speaks of a "valuable precedent" that will lead other countries to "follow the French example".

The FTT is not the only European-scale tax proposal Paris would like to see implemented.

Sarkozy and German Chancellor Angela Merkel confirmed, on 6 February, that their countries are working relentlessly to introduce, by 2013, a common corporate income tax. According to the French president, this would help create a "stability zone in Europe".

France is considering in this context widening its tax base while simultaneously reducing its rate (34.4% in France at present, compared with 29.8% in Germany).

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