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Time for Tobin

Ireland and the European Financial Transactions Tax Proposal

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SUMMARY

In the context of the recent international financial crisis, one principally derived from the reckless speculative behaviour of numerous banking and financial corporations, the long-term hesitancy towards a financial transactions tax (FTT) tax has begun to thaw.

Most recently the European Commission and Parliament have set in train a process to see a FTT introduced in a number of EU countries from 2014. The European proposal is far-reaching and will be difficult to avoid for financial institutions who wish to remain active in the implementing states or to trade EU issued financial assets. To date Ireland has been unwilling to support the FTT proposal. An EU wide FTT would give a net tax gain of between €300-550m per annum for Ireland. The gains are likely to be smaller, but positive, if Ireland but not the UK adopts the FTT.

Ireland has much to gain from an EU-wide FTT and should adopt a more assertive position in campaigning for it.

KEY POINTS

- The recent financial crisis has reignited interested in a financial transactions tax (FTT)
- A FTT would: (i) allow states to more adequately monitor the financial sector; (ii) provide additional taxation revenue; and (iii) reduce the volume of high-risk financial transactions.
- The European Commission and Parliament have proposed a FTT which is being pursued by 11 member states.
- The European FTT proposal is structured to capture activities in all markets, all instruments and all actors.
- To date Ireland has been unwilling to support the FTT proposal.
- An EU wide FTT would give a net tax gain of between €300-550m per annum for Ireland. The gains are likely to be smaller, but positive, if Ireland but not the UK adopts the FTT.

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Introduction

Over the last four decades, since its initial suggestion in 1972 by Nobel Prize winning economist James Tobin, various names have been given to the proposition of implementing a very small tax on global capital flows. The Tobin tax, a Financial Transactions Tax (FTT), a Currency Transaction Tax (CTT) and the Robin Hood tax are among the names for the proposal and variations of it.

In the context of the recent international financial crisis, one principally derived from the reckless speculative behaviour of numerous banking and financial corporations, the long-term hesitancy towards this tax has begun to thaw with politicians, governments and international agencies joining the previous coalitions of many researchers, economists, NGOs and development charities in calling for the introduction of a FTT.

Most recently, at a European level, the European Commission and Parliament have set in train a process to see an FTT introduced in a number of EU countries in 2014. To date, Ireland has been hesitant towards the adoption of this proposal.

Why an FTT?

There are three reasons why the idea of a FTT is worthwhile, and has gained added support, recently:

(i) The implementation of such a tax would necessitate Central Banks and Governments to establish real-time monitoring mechanisms for the various flows of financial transactions happening each and every day. It was apparent as the 2008 financial crisis unfolded that Governments and their agencies had limited insight into the nature and scale of financial transactions; something which impeded a response to the crisis. Despite this, as the crisis proved, it has been Governments and societies who have had to step-in and pick up the pieces when things go wrong – a fact demonstrated across the world via multiple financial sector collapses over recent decades. From a societal perspective, it would be worth implementing a FTT that provided as a bi-product immediate information on financial movements and liabilities even if the tax raised no money over and above that required to establish and run such a system. However, given the scale of financial transactions a significant amount of revenue will be raised.

(ii) A FTT would provide governments with a large source of additional tax revenue. Despite the small tax rates levied by a FTT, the volume of international financial transactions is such that a small percentage of a big sum adds up to a large amount of tax revenue. Estimates vary, depending on the tax rate chosen, and the definition of the tax base (what is taxed and what is not). Irrespective, such revenue serves as a contribution from the financial sector towards the large cost of the rescue operations it benefited from either directly or indirectly during the recent financial crisis.

(iii) The presence of a FTT would dampen the attractiveness of short-term speculative financial transactions – the original focus of Tobin's proposition four decades ago. Often such transactions are targeted at vulnerable countries and their speculative nature suggests that they are driven by profiteering and are far removed from any real (and useful) economic activity.

The EU Proposal

In September 2011, the European Commission produced a directive suggesting the establishment of a FTT across all EU member states. Objections from a number of states, including Ireland, prevented unanimous adoption of the proposal and subsequently 11 countries indicated their willingness to implement a FTT under an enhanced co-operation procedure. Their approach was endorsed by the European Parliament and the European Council in late 2012 and early 2013. The 11 member states are: Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.

The proposed minimum rates for the FTT are 0.1% (one-tenth of one per cent) on the trading of bonds and shares and 0.01% (one-hundredth of one per cent) on the value of derivative agreements and 'financial market bets'. The rates are minimums as countries with the EU retain the right to set individual tax rates and could choose higher levels if desired. In all cases the tax falls separately on each of the parties to the transaction, i.e. buyers and sellers will both pay.

The scope of the FTT proposal takes a 'triple A' approach as it aims to cover all markets, all instruments and all actors. Thus, the tax has been designed to limit opportunities for avoidance via tax-planning, substitution and institutional/transaction relocation.

Through a series of 'principles', it has been designed to ensure that the tax is levied if at least one of the financial institutions involved in a transaction is deemed to be established (tax resident) in the EU – even if the transaction occurs outside the EU. This is known as the 'residency principle'. A further principle, the 'issuance principle', ensures that the trading of all securities originally issued in the EU is subject to the tax irrespective of the location of that trade. Similarly, the payment of the FTT has been linked to the formal transfer of legal ownership of assets – akin to stamp duty; this is known as the 'ownership principle'.

The comprehensiveness of this design renders the tax difficult to avoid for financial institutions who wish to remain active within any of the 11 member states or who wish to continue to trade in any EU issued financial assets.

The FTT proposal exempts private transactions by households, those made by SMEs, insurance contributions and capital raising activities by companies and public bodies.

Estimates from the European Commission's impact assessment of the proposal suggest declines in financial transactions principally driven by decreases in risky financial trades. They have estimated that share and bond transactions would fall by 15% and that high-risk derivative and 'financial bets' would fall by 75%. While these declines reduce economic activity in some sections of the financial sector, they simultaneously reduce risk from that sector – one of the objectives of the FTT. Taken together, various research papers have estimated that the costs and benefits of an FTT would have a small impact on GDP; estimates of between -0.2% and +0.25%.

There are possible disadvantages for consumers who may see marginally higher interest rates (estimates of +0.07%, plus seven-hundreds of one percentage point) and for institutions who may be exposed to double taxation regarding some trades conducted in territories with existing FTT like structures that are not party to the EU proposal and do not have relevant double taxation agreements in place with EU states.

The proposal also includes a commitment by Eurostat to collect and publish annually data on the financial flows subject to the FTT within the EU.

Finally, estimates of the annual revenue likely to be generated from this EU proposal range between €30-35 billion, or 0.4-0.5% of the GDP of the participating states. It would be higher, at approximately €57 billion, if all EU member states implemented the FTT.

Ireland and the FTT Proposal

In Ireland the European proposal for an FTT has been met with interest and hesitancy. Government has indicated that it finds the concept appealing; something which is unsurprising given the central role financial institutions played in Ireland's economic crash.

However, to date the Government has been unwilling to support the proposal unless it is adopted for all EU countries; a position principally driven by fears of competitive disadvantages between Dublin's IFSC and the City of London's financial centre. Yet, given the aforementioned structure of the FTT proposal, the ability to avoid the tax seems limited and there are few, if any, financial advantages associated with institutions relocating or restructuring if a FTT existed in Ireland but not the UK.

Estimates of the net revenue gain from the introduction of the tax suggest additional revenues of between €300m-550m per annum when account is taken of the likely simultaneous elimination of stamp duty on share transactions. Some of the gross revenue would go towards the EU, the current proposal is 66%, and the remainder would be available for domestic purposes. There may be further indirect exchequer gains from reductions in the amounts required to be raised elsewhere for meeting and increasing EU budget contributions. By 2020, the European Commission estimate that Ireland would save just over €500m in EU budget contributions on foot of the FTT.

The precise exchequer and economic implications of Ireland joining the existing EU FTT proposal are difficult to determine. There would be gains and losses with the likely outcome being some small additional exchequer gains – given the volume of revenue and the limited incentives for transaction/institution relocation. However, it would be preferable for the FTT to be introduced across most EU countries simultaneously. As such Ireland needs to play a more enhanced role in supporting the moves at a European level and convincing other Governments, such as that in the UK, to support a FTT. To date such leadership has been lacking.

Using FTT Revenues

Over time there have been various areas cited as the best place to use the additional resources a FTT would generate. These include providing exchequer revenue for general use, providing funds for the budgets of international agencies such as the European Commission and funding enhanced budgets to finance overseas aid and development. For much of the last two decades, it is the latter area that has been most prominent with arguments centring on enhancing funding to allow countries reach the UN ODA target of 0.7% of GDP. However, the current EU proposal is focused on using the FTT revenues for EU budgets and internal exchequer funding. In all likelihood, the scale of the revenue raised by a FTT would be sufficient to provide funds for domestic, international and development needs. However, it would seem timely that the development community re-asserted the case for funding development from FTT revenues.

Conclusion

For four decades the idea of imposing a small tax on global capital flows has appeared and re-appeared without being successfully implemented. The inherent relationship between the recent severe world financial crash and the behaviour of the financial sector clearly highlights that the uncontrolled and unmonitored speculative ways of the past cannot be allowed to return. The current EU FTT proposal is cleverly structured and offers a way of raising additional tax revenue, dampening needless speculative activities and monitoring the activities of the financial sector. Ireland has much to gain from an EU-wide FTT and should adopt a more assertive position in campaigning for it. After four decades, its time has surely come.

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