A big step, but further to go:
Response to the European Commission report on Financial Sector Taxation

Last week, the European Commission (EC) took a big step towards following through with statements that it would "lead efforts to set up a global approach for introducing systems for levies and taxes on financial institutions." It submitted a document to the European Parliament that thoroughly examined the merits and drawbacks of two instruments: a Financial Activities Tax (FAT), and a Financial Transaction Tax (FTT).

The Robin Hood Tax campaign welcomes the EC's assertion that a FTT could achieve "a triple dividend" by:
i) raising substantial revenue; ii) curbing harmful short-term speculative investing; and iii) by ensuring that the financial sector pays its fair share of public finances, particularly in light of its culpability in the recent financial crisis and its astonishing exemption from the EU's common value added tax (VAT) system.

We strongly agree with the EC's notion that the revenue could be used "to finance development cooperation," and "help developing countries to combat climate change." And we commend the EC's resolve to take the lead in pushing through financial sector taxation on a global scale.

Unfortunately, in the case of a FTT, the EC's conclusions fell short of the leadership to which it aspires. Although the report favoured a FTT at the global level, it cautioned against unilateral implementation at the European level due to worries over tax evasion and market distortions. We believe these criticisms do not stand up to scrutiny, for reasons outlined below.

We were also disappointed to see no explicit mention of a European FAT being linked to helping the poorest and marginalised in Europe and around the world and to tackling climate change. The Robin Hood Tax campaign would like to see revenue raised for these objectives from implementation of FTTs in Europe that could provide tens, if not hundreds of billions, in stable revenue on an ongoing basis. Introduction of the FAT would be a substantial first step and it is critical that this money is specifically linked to helping those who have been hit hardest by the financial crisis they did nothing to cause. As the EC states, banks are directly responsible for the crisis, and so they should be made to contribute directly to those who lost out.

In moving towards international consensus, it is imperative that the EU leads by example, and pursues viable FTTs at the European level whilst explicitly linking revenue from all financial sector taxes, including the FAT, to global public goods and those most in need at home.

The Details

Financial Transaction Tax

Which of the FTT models discussed in the report should be implemented

- It is important that the EC pursues a broad based FTT which would be levied on stocks, bonds and derivatives, as opposed to the narrow-based FTT also described in the report. Derivatives represent a large portion of the potential tax base.
- The proposed justification for not taxing derivatives is that they are more complicated than taxing stocks or bonds. This argument is unfounded because whilst *trading* in Over-The-Counter derivatives remains de-centralised, *clearing and settling* these trades is now globally centralised and automated. This covers virtually the all large-value markets for derivatives, including interest rate, foreign exchange,

equity, credit, and commodity products, and is increasingly electronically automated. These developments follow similar events in the other great Over-The-Counter market, that for foreign exchange, where 95% of the entire volume of the market is settled through the Continuous Linked Settlement (CLS) Bank.

How a FTT targets the riskiest behaviour

- The EC report posits, "It is impossible to disentangle harmful from beneficial transactions based on their time-horizon." This statement is not true. Under a FTT all transactions, short- or long-term, would be taxed at a very low rate (0.05 to 0.005 percent) but longer-term investments such as, for example, pension and insurance funds, would not be affected by this level of taxation.
- Products that are traded more frequently will face a higher tax burden because a FTT is cumulative. In this manner, the FTT acts as a disincentive to excessively short-term trading. A growing portion of the financial market is comprised of high frequency trading (HFT), in which computer programmes or algorithms are used to trade and sell large volumes in very short time periods, generally milliseconds or microseconds (one millionth of a second). HFT now represents an estimated 60 to 70 percent of trading volume in the entire US financial market. HFT adds little social value to the financial sector, but results in serious volatility. This volatility is illustrated best by the "flash crash" of May 6, 2010 when a high value trader sold 75 thousand stocks worth USD 4.1 billion in 20 minutes. The sudden drop in value spurred high-frequency traders to go into a spiral of selling, causing US stock prices to plummet, some down to a cent, and then rebounded within minutes. A FTT impacts on this risky behaviour by increasing the costs of speculative trading, thus disincentivising high frequency trading.

Why a FTT will not cause tax evasion and industry relocation

- The report argues that if a FTT were to be implemented unilaterally, some transactions might move to jurisdictions that do not apply the tax in order to avoid it. This criticism is overstated. It is based largely on Sweden's short-lived experience with a FTT. This tax was flawed in its design and should not be used as a comparison for a well implemented FTT. The criticism is also weak for a number of other reasons:
- First, the report downplays other successful cases of unilateral FTT implementation. FTTs are commonplace. Besides those discussed in the report – the UK, Korea, and Taiwan – FTTs have been successfully implemented in more than 40 countries including the US and China.[1] FTTs have raised billions of dollars of predictable revenue without serious avoidance. For example, as discussed in the report, the UK levies a 0.5 percent stamp duty on transactions of shares, which yields GBP 3 billion per year. The imposition of this tax has not caused companies to take their business elsewhere. They continue to trade on the London Stock Exchange, making it one of the most successful and vigorous markets for shares in the world.
- Second, as mentioned in the report, there are many reasons for investors to trade in a particular location – reasons that have more significance than the domestic tax regime. Consider the advantages gained by investors from being concentrated in one marketplace: immediate access to information and trading partners. The gains from these so-called network externalities greatly outweigh the burden of a FTT, and would mitigate the incentive for firms to move to an untaxed location in the case of unilateral implementation.
- Third, in recent years financial markets have become increasingly computerised and automated, making avoidance difficult. Banks participate in these settlement systems as they offer protection from risk of default. The Continuous Linked Settlement (CLS) bank for example now settles 75% of all wholesale foreign currency transactions worldwide (equating to 95% of the value of the market). A FTT could first

[1] FTTs have been introduced permanently or temporarily on such financial areas as stocks, corporate and government bonds, futures and general computerised financial transfers over the last few decades in more than 40 countries including: Argentina, Australia, Austria, Belgium, Brazil, Chile, China, Colombia, Denmark, Ecuador, Finland, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Malaysia, Morocco, Netherlands, Pakistan, Peru, Philippines, Portugal, Russia, Singapore, South Korea, Sweden, Switzerland, Taiwan, UK and US.

be levied on the enormous currency market with little risk of evasion. Global currency exchange is the largest financial market, worth USD 4 trillion per day.

- Fourth, the report states that revenue generated from a FTT would be highly concentrated in a few countries, namely those with major financial centres. We take issue with this analysis. The European VAT, for instance, is collected nationally and pooled together in Brussels to be spent in a commonly agreed way as decided by EU Member States. Where and how revenue is collected through FTTs is open to design, learning from the many examples of FTTs that already exist both within and outside of the EU. As study of the market in currencies has shown us, the geography of the trade is not a relevant factor, it is the parties to the trade, themselves, that are taxed through the High Value Settlement System. For example, if the wholesale market in Euros were to be taxed, then it would not matter where in the world the counterparties were in fact situated, the tax would be captured at the CLS Bank and then directed to wherever the CLS Bank is instructed to send it. In other words there is a distinction between what you tax (ie shares, bonds, foreign exchange, derivatives), who you tax (the counterparties) and where you tax it (on exchange or Over-The-Counter). It is not sufficient to focus only on the location of the largest markets.

- There is a responsibility for money raised from FTTs to be used for global public goods, as the EC paper states, but there is also much potential for the EU to raise substantial revenue from its financial markets to be spent on the needs of the European region itself.

Financial Activities Tax

The characteristics of a FAT tax and revenue use

- We stress that any revenue from a FAT must be linked to fighting poverty and climate change in Europe and around the globe. A FAT would be a substantial step towards seeking a fairer contribution from the financial sector and the additional revenue generated needs to be from the outset linked to those that have suffered disproportionately from the financial crisis that they did nothing to cause.

- Ultimately the Robin Hood Tax Campaign would prefer to see a FTT implemented because it has the most potential to raise revenue. However, a FAT may offer an important first step and have a complementary part to play. To be worthy of praise from the campaign, revenue generated from a FAT would have to be substantial enough to help address domestic deficits and global public goods. The EC report discussed a 5 percent addition-method FAT tax, with an estimated yield of EUR 25.9 billion. This is a start, but with such a bloated financial sector and such an urgent need to find additional revenue we would like to see the EC go further.

In conclusion

- The Robin Hood Tax Campaign applauds the European Commission's call for unilateral implementation of a EU-wide FAT tax, but new revenue generated must from the outset be linked to tackling climate change and poverty, in Europe and around the world. The financial sector has a direct responsibility to help those who have suffered disproportionately from the financial crisis they did nothing to cause.

- The EC's assertions that unilateral implementation of a FTT would cause transactions to move elsewhere do not stand up under scrutiny. While a global FTT is of course desirable, in moving towards international consensus it is vital that the EU take the lead by implementing suitable FTTs within its own market.