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Taxation and Customs Union

Response by Sveriges Riksbank to the Consultation by the Commission on an Initiative for the Taxation of the Financial Sector

The Sveriges Riksbank (the central bank of Sweden) wishes to respond to the Consultation. However, we do not find it useful, e.g. since the Riksbank does not possess expertise on specific tax matters, to answer all the detailed questions. Instead we want to express our general views on the proposed tax. We also want to share our experiences of having implemented, and terminated, such a tax.

The so called Tobin tax is an ever-green issue. At its inception in the 1970s, it was primarily intended to reduce capital flows in order to increase flexibility for countries with fixed exchange rates, enabling them to pursue long-term policy strategies without having them thwarted by counteracting short-term currency flows. Since then, the issue of a "Tobin tax" has re-emerged a number of times. The objectives of introducing the tax have shifted. Sometimes the aim focuses on reducing specified financial transactions, sometimes the purpose is to gather funds for various causes.

For Professor Tobin, it was of secondary importance how the revenues from the tax were used. He originally suggested putting them into UN funds for various beneficial purposes, but did not dwell on this in any detail. Tobin also noted that a large portion of the revenues must be left with the countries implementing the tax. This would provide strong incentives to really bring in the tax revenues, thus contributing to global coverage which is an important prerequisite for a successful outcome.

In more recent years, the public interest in a tax stems less from the original objective of "throwing sand in the wheels", although this was certainly also an issue in the ATTAC movement's proposals ten years ago, than from the objective of amassing funds for various purposes. A variety of worthy causes, including poverty relief and measures to combat climate change, have been mentioned.

The background to the present EU Consultation are demands for using the Tobin tax on financial transactions in order to collect public funds which could be drawn on to finance rescue operations in the financial system. The explicit aim was that the financial system should be able to take care of itself financially, and not have to rely on the taxpayers. But equally important, according to the proposal, was that the tax

would reduce the “excessive”, or “speculative” element (which in our opinion is extremely hard to define) of the financial market, leading to improved stability.

The Riksbank’s basic belief is that taxes should not distort incentives in other fields or markets. A carbon tax should therefore be levied on those whose activities have a negative impact on the climate (e.g. those who travel by air or use polluting cars). Providing support to people which have been hit by the recent high prices on food and other commodities should be based on broad participation from taxpayers and international organisations. We also believe that the proposal to apply a Tobin tax in order to build a stabilization fund for ailing banks should adopt a more bank-centred approach than taxing financial transactions generally. A turnover tax will in our view be more distortive than necessary compared to the hoped-for benefits.

Sweden is presently building a bank stabilization fund. Its purpose is to finance support measures for the banking sector that cannot be accommodated by the bank owners themselves. The fund might be seen as a corollary to and an extension of the existing deposit guarantee fund with more money and greater scope to take a variety of measures to protect the banking system, including the depositors and other stakeholders. The targetted size of the fund is 2.5 per cent of GDP. The amount may prove inadequate in a certain crisis situation but the fund has access to credit lines from the government – to be repaid later. The funding fees, to be paid yearly, are calculated as a fraction of each bank’s balance sheet total, excluding unsecured debt and equity.

In our view, such a focused fee, which is closely related to the risk a specific bank will pose to the overall system, is a better instrument than a general tax on financial transactions. If – contrary to our expectations - such a tax could achieve broad global acceptance, it will lead to distortions and other negative side-effects.

Sweden has experience of the use of the Tobin-tax concept. In 1987 a tax on a variety of securities transactions was introduced. The aim was primarily to reduce the volume of trades which were found to be excessively high compared to the “real” underlying transactions. The tax was successful to a point in that the trades were drastically reduced in Sweden since the market moved abroad, mainly to London and New York. (The market quickly returned to Stockholm when the tax was abolished in 1991). The revenue received from the tax was thus only a fraction of what the authorities had expected. Academic studies indicate that the tax did not reduce volatility in the relevant markets, but it did reduce market liquidity.

This experience leads us to make a few observations, which apply generally to this form of tax.

The first is that even a very low tax rate will be an inducement to move the market elsewhere since the margins on these transactions is quite slim.

The second, which follows closely from the first, is that a tax will not work unless there is harmonized implementation by a wide group of countries. It may be the case that complete global coverage is not needed since some small, less-developed

countries will not possess the infrastructure and the financial credibility to take over this business. But one certainly needs to include all the other countries, as well as offshore financial centres. Today, much more than in the 1980s, the technology has made it simple to conduct a transaction in another country by using effective computer systems.

The major financial centres in New York, London, Tokyo and other places contribute significantly to employment and to the overall revenues of the economies in which they are located. We find it difficult to believe that governments would be willing to give this up.

The third observation is that there is also a risk of leakage to other instruments. Not only spot transactions but all kinds of forwards and other derivatives must be taxed. Trade in commodities, which could function as proxies to financial transactions, must be included. It will be very difficult, not to say impossible, to calibrate the tax rates on various more or less related instruments to avoid arbitrage opportunities and loopholes. This deficiency will lead to ineffective and distorted markets.

A fourth observation is that taxes on currency transactions, should they be included, will hit small countries and countries outside currency unions harder. Countries in the euro zone will not be taxed on their internal currency transactions, but a non-euro country will be taxed also for ordinary export/import-related transactions with the euro countries; hence the tax will in effect become a customs fee.

Alternatively, if you try to tax other financial transactions you will find that it is more or less infeasible to calibrate the charges on different types of cash, forward and other derivative instruments – which will lead to an ineffective and distortive system. For cost reasons, the financial agents will aim to evade the tax by using less-efficient instruments and markets. Market contraction will lead to a loss in liquidity and hence possibly also to an increase in volatility. The transfer of markets from regulated to non-regulated jurisdictions will affect the level playing field and may lead to a regulatory “race-to-the-bottom”.

To summarize: While the Riksbank shares the aim of making the financial sector assume an increased financial responsibility in paying for its own “negative externalities”, it does not find that a tax on certain financial transactions is the optimal response.

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