Bank Taxes in Europe

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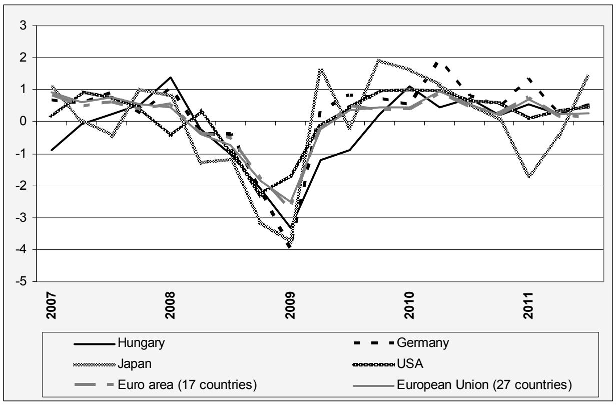
SUMMARY

The ongoing international financial crisis plays a decisive role in our daily lives. As in the previous century, the problem began in the United States and spilled over from there to the member states of the European Union. The history and causes of the crisis between 1929 and 1933 is well known. It seems that we were unable learn from this. The current crisis has no respect for national borders or boundaries of continents. Its effects and treatment measures vary from country to country, depending on how unprepared the country was for the crisis. In the public opinion, banks are responsible for the outcrop of the crisis. In the European Union there is great popular support for the idea that banks should cover a significant part of the liabilities because of causing the crisis. For this reason, and to improve the balance of their budgets, many states in the EU are thinking about imposing a bank tax. This study examines the justification for and the possibilities of bank taxes.
Keywords: crisis, bank tax, European Union
Journal of Economic Literature (JEL) code: G01, G21, H12

INTRODUCTION

On different continents the impact of the actual financial crisis on the gross domestic product has occurred at different times (Figure 1). While the growth of the GDP ceased in the United States, in Japan, Germany and even in Hungary it increased in the early period. However, in the first quarter of 2008 there was a recession in the EU, in the USA and in Japan. The first of them to recover from its weakened status was the United States. Despite this, Japan showed the first positive GDP value in the second quarter of 2009. Germany, which is the European Union's largest economic power, had the largest negative value, which was more than 4%. The euro area (2.7%) and the European Union (2.5%) showed approximately the same rates. From 2009 economic growth began, which was just a short process. In the beginning of this year in Japan there was a decrease, which turned into a negative value in the middle of 2009. From its bottomed out status (-3.3%), Hungary achieved a positive GDP in the last quarter. At that time Germany was emerging out of another poor fulfillment period. Weakening and strengthening periods occurred in turn from 2009 to the last quarter of 2011.Between 1929-33 an intense production process leading to an overproduction crisis was responsible for the situation. For their part in the formation of the current financial crisis banks are being punished in many countries by taxes and other nations are thinking of introducing such taxes.



Source: edited by the author, based on the OECD database http://stats.oecd.org/index.aspx?queryid=350 Downloaded: 08. 02. 2012.

Figure 1. Growth of Gross Domestic Product

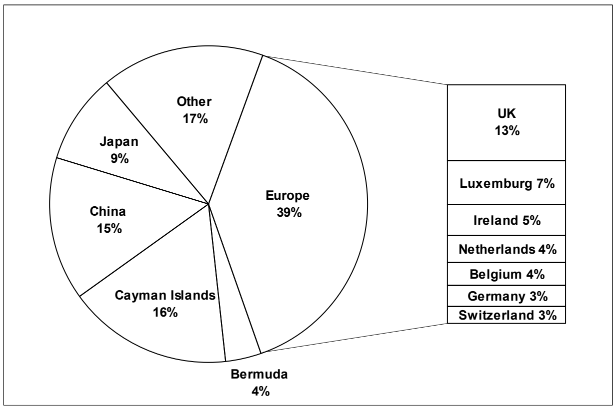
THE WAY TO THE FINANCIAL SECTOR TAX

Among other things securitization and subprime loans are activities which led the need for the banking sector to make amends. Securitization is when loans are isolated and financial institutes issue stocks, which cover the loans themselves. The securitization of loans played an important role in the development of the crisis.

This process produced several products:

- Asset Backed Securities (ABS)
- Mortgage Backed Securities (MBS)
- Credit Default Swaps (CDS)
- Collaterized Debt Obligation (CDO).

Of the above, I examine the importance of ABSs in investment and their effect. In the case of theAmerican asset backed securities Japan and China had together 24% of ABSs European participation was outstanding. The UK took the largest part of the members of the EU, while Belgium, Germany and Ireland together held approximately one-third of the EU owned ABSs (Figure 2).



Source: MNB-National Bank of Hungary, Report on financial stability April 2008 http://www.mnb.hu/Kiadvanyok/mnbhu_stabil/mnbhu_stab_jel_20080415, Downloaded: 14.02.2012.

Figure 2. Foreign Holdings (USD 1,500 billion) of Long-term U.S. Asset-backed Securities (ABS), by Major Investing Countries (June 2007)

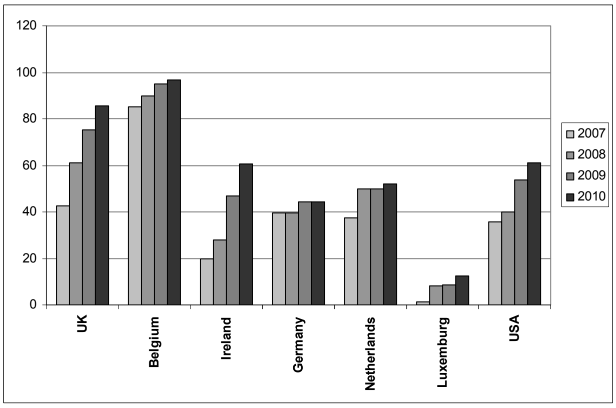
As discussed above, the crisis did not occur in different countries at the same time and to an equal extent. Among other things, this was due to the mentioned ownership structure of ABS as well. To relieve and handle the situation states gave different amounts of support for crisis management and stimulating the economy (Table 1). For instance, Belgium and Germany, which each had 3-4% of the securities, each lent about 30%, and the Netherlands, which had 4%, gave 40% of their GDP in support. The United Kingdom, which had the largest part of the ABS in the European Union, offered more than 50% the amount of its GDP from public funds. In the case of Iceland this fund was more than two and a half times larger than the GDP. From 31 March 2009 there was $10 billion (6.2%) support in Hungary. This rate was low compared with Western European countries.

Table 1
Public Funds[1] committed Between 1 September 2008 and 31 March 2009 to Address the Global Financial Crisis

Country	Ratio of GDP (%)		Amount (billion dollars)	
	Total	of which: fiscal stimulus	Total	of which: fiscal stimulus
United Kingdom	51.6	4.1	1438	114
Netherlands	39.8	0	362	0
Belgium	30.9	0	164	0
Germany	28	6.3	1069	241
Iceland	263	0	0	0
Hungary	6.2	0	10	0
USA	92.9	5.2	13255	742
World	33.8	4.3	20955	2655

Source: UN/DESA: Monthly Briefing World Economic Situation and Prospects, 02. April 2009. http://www.un.org=esa/policy/publications /wespmbn/sgnote_7.pdf, Downloaded: 13.02.2012.

Governments generally used lavish aid programs and they did not handle state money with care. Government debt has been growing since the outbreak of the crisis (Figure 3). This process led to a big problem which had not reared its head since long ago: countries are in bankruptcy and several are going bankrupt. The largest and the most conspicious government debt growth was in Ireland, where it increased from 1.4% in 2007 to 12.6% in 2010. The UK is facing a significant problem with a 42.79% higher government debt, as is Ireland with 40.87% higher debt. The USA has less debt (25.57%) than previous countries. In spite of this, there is still an increase of 1.7 times from the base year 2007 to 2010. Germany was in the most balanced position. as in the reviewed period debt increased by only 4.85%.



Source: edited by the author, based on OECD database http://stats.oecd.org/index.aspx?queryid=350 Downloaded:14.02. 2012.

Figure 3. Total Central Government Debt (% of GDP)

[1] *Includes financail bailout packages (including government guarantees on bad debts), liquidity injections into financial systems and fiscal stimulus packages.*

The crisis is changing its nature. It was financial, but is turning into a crisis of trust. This is one of the most difficult types of crises to resolve. A few consequences of it are:

- liquidity and capital become more expensive for the present and the future., i.e. the price of cash increases.
- there are stricter regulations for credit institutions and banks in order to increase the perceived predictability of capital requirements,
- increasing consumer advocacy and lobbying.

One method of finding a way out of this situation is the increasingly popular use of bank taxes.

LIABILITIES OF THE BANKING SECTOR

Daily uncertainty and burdens which have been created by the crisis cause more and more tasks for governments day by day. The creators of the ABS and other scrutinized loans (MBS, CDS, CDO) were the banks. Thus, banks who are responsible for the crisis have to deal with the situation that they made. Furthermore, in the EU countries expect an improved fiscal balance from the tax. "In the process of the relative stabilization of the financial system, plugging holes in the budget – that had appeared because of that process – became important. One of the solutions – which has political popularity – is introducing various bank taxes" (Kovács 2011: XX).

In September 2009 at the G20 meeting in Pittsburg the IMF was requested to create possible alternatives to a bank tax.In June 2010 it made two suggestions (IMF, 2010):

1. Financial Stability Contribution (FSC)
2. Financial Activities Tax (FAT)

In October 2010 the European Comission chose three different types of taxes to discuss: the FAT, the adoptation of a levy computed on balance sheets elements, and the FTT.

1. Financial ActivitiesTax (FAT), which is the IMF's proposal. FAT user member states: Denmark, Italy, France.
2. Adoptation of a levy computed on balance sheets elements. This type is the most popular in the European Union (Figure 4).
3. a Financial TransactionTax (FTT, also called Tobin tax). States using FTT: the United Kingdom.

The Tobin tax is not a twenty-first century invention. Its idea comes from the beginning of the 1970s. This was the time when the US dollar's exchange to gold and some other currencies in a fixed exchange rate was ended. In financial markets this made turbulence phenomenon a possibility. "The Tobin tax is a possible theoretical tool for maintaining the stability of the international financial market that suggests a tax to depend on the transaction's size in the case of money flows from currency conversion " (Kovács 2011: XX). There were several attempts to introduce such a tax in Europe. In 1974 it was introduced in the UK for British securities on the British stock exchange. The rate was set at a very low level. Sweden in 1984 imposed it on shares and in 1989 on debt securities. It caused a decrease in turnover, and therefore it was abolished in 1991.In 2011 the Comission proposed to the Council the introduction of only the FTT, saying that the final proposal would be developed by December 2011 to make way for introduction in 2012. However, its finalization has been delayed.

Source: edited by the author, based on the European Banking Federation database

Figure 4. Member States Adopting a Levy Computed on Balance Sheets Elements

The European Banking Federation opposed the FTT for several reasons. Among other things they refer to the problem of bad timing and to its non-standardized introduction. Books dealing with the Tobin tax mention that it is only effective when introduced all at once and globally. "Due to the mobility of money and capital markets, circumvention of national and regional introduction will be an obvious answer from the market. In addition, the timing of introduction is not appropriate because the banks' lending activity will be blocked., thus impeding the recovery of economy" (Kovács 2011: XX).

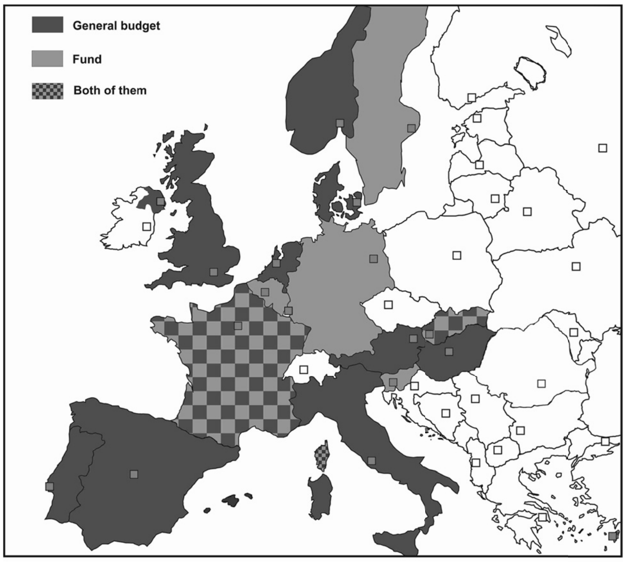
Tax rates are not uniform within the European Union (Table 2). Some states break up each category into sub-categories, based on amount, with different rates. For example, in the case of Germany there are five rate categories, not counting the tax free category.

Table 2
Bank Taxes in the European Union

Country	Name	Rate (%)
Austria	Bank levy/Stability levy	no levy< €1billion, 1billion € ≤ 0.055% ≤ 20 billion €, 20 billion € < 0.085%, The levy on derivatives is calculated as follows: 0.013% on the volume of all financial derivatives
Belgium	Bank levy	0.15%
Cyprus	Special bank tax and financial sector stability fund	For 2011 and 2012 the rate will be 0.095% on deposits, and it will not exceed 20% of each financial institution's taxable income for that period
France	Systemic Risk Bank Tax	0.25%
Germany	Restructuring Fund/Special bank levy	Relevant liabilities exemption< 300million €, 300 million € ≤ 0.02% ≤ 10 billion €, 10 <0.03% ≤ 100 billion €, 100 billion € < 0.04% ≤ 200 billion €, 200 billion € < 0.05% ≤ 300 billion €, 300 billion € < 0.06%,
Hungary	Tax on financial institutions	0.15% ≤ 50 billion HUF, 50 billion HUF< 0.53%
Sweden	Stabilization Fund/Stability Fee	0.036%
United Kingdom	Bank levy	0.075% and 0.0375% for longterm liabilities and uninsured deposits

Source: European Banking Federation database 2010

The use of inland revenues is different in the member states (Figure 5). The most common approach is to return it to the general budget. However, there are states that separate revenues into a fund to handle a possible crisis. In addition, there are countries that accept both options (IMF 2010).



Source: edited by the author, based on European Banking Federation database

Figure 5. Destination and Use of the Financial Sector Tax

In Hungary, the bank tax was introduced in 2008. This first type of tax was imposed on state-subsidized forint interest income after mortgage interest, to be paid at the rate of 5% of interest income. The second type of special tax was introduced in 2010. This is Europe's most popular approach, a balance sheet total tax imposed by banks, as previously presented in Figure 5,. It is based on the previous year's adjusted total assets. The rate is 0.15% below £ 50 billion, and 0.53% for assets above that amount, from 2011 (Table 2). In Hungary, the transaction tax being currently planned is not a Tobin tax, since it is not a tax on speculative capital transactions, but in practice a VAT-type tax. The administrative and monitoring costs will be very high compared to income it produces, so it would be much easier if they built it into the value-added tax. The proposed transaction tax would be levied only up to a certain limit. This amount is not yet final. Above this limit, tax will not be levied in order to encourage the major economic players to keep their money in Hungary. Even so, they may continue their activities in countries with lower or no transaction costs.

Outside Hungary the situation is similar. The mass introduction of transaction taxes would also mean a significant change in London and Frankfurt's international role. A significant proportion of revenues from this would flow to the two financial centers. However, those wishing to avoid such taxes could choose another financial center in the for their transactions. Improvement in the member countries's situation from the amount they received from bank taxes should reduce member states' payments for the EU.

Conclusion

Unfortunately, the crisis is far from over. In the road to recovery there are obstacles which create new and growing problems against us. The situation of several states in the European Union is worrying. Analysts proclaim the imminent bankruptcy of several countries, or even fear the collapse effect of countries in the region. In this stormy situation bank taxes means a way out of the crisis. In some countries they expect to improve the balance of their budgets with bank taxes, while in other countries they use the money from taxes to form bank rescue packages in case of another recession. Today, in addition to everyday people and companies, countries ranked as high risk are having difficulty getting credit. Yet, new credit is required for handling the growing indebtedness and stimulating the economy. Because bank taxes have a negative effect on lending activity they may have an effect opposite to the expectations. From the crisis taxes itselves we can not wait miracles. If in hasitant countries' governments introduce bank taxes despite of bank sector's objections, banks won't have rest. Their role in the current crisis they will bear its burden for a long time. The European Central Bank did not support the Tobin tax, and neither did the European Banking Federation. However, the EU insists on resolving the issue, which can be FFT, FAT, or VAT. A decision in this regard has not yet been made. One thing is certain, that only those types and extents of taxes should be introduced that will not hold back economic growth.

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