The Financial Transaction Tax – A Wrong Track?

Heavy Burden on Private Households and Non-Financial-Companies in Germany

July 2013[1]

Executive summary

The financial transaction tax (FTT) has been intensively discussed since 2007 in the context of the financial crisis. A number of countries (e.g. UK and Sweden) oppose the financial transaction tax because they are concerned about negative consequences. As a result a pan-European initiative failed. At the beginning of 2013 eleven EU member states decided to implement a FTT under the so-called "enhanced cooperation". For this objective the EU Commission proposed a directive on the FTT on 14 February 2013.

Overall effect

The declared objective of the legislator is not to impact negatively retail investors and companies in the real economy with the FTT. This study shows that, under the current proposals, this objective cannot be met. Using conservative assumptions the burden of the FTT as proposed by the European Commission amounts to between € 5.0 and 7.3 billion annually for private households and non-financial companies in Germany.

This is a conservative estimate, as the FTT burden from financial transactions with no direct link to end users (e.g. repurchase agreements), as well as secondary effects, are not included.

The FTT also counteracts other political objectives such as to promote private old-age provisions or to improve the access of small and medium companies to capital market finance.

FTT burden for private households

For private households, almost all forms of private old-age provision and wealth accumulation are negatively affected by the FTT. This applies to direct investment in equities, bonds and the indirect wealth accumulation through investment funds, as

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[1] This summary is translated from the German summary of the Study "Die Finanztransaktionssteuer – ein politischer Irrweg? Auswirkungen auf private Haushalte und Unternehmen in Deutschland" conducted by Deutsches Aktieninstitut and Oliver Wyman. The study has been published on the 18th of July 2013 and is available in full German text on www.dai.de and www.oliverwyman.de

well as capital funded life insurances. This results in a total annual burden of € 2.6 to € 3.6 billion.

For an average German household the annual tax costs add up to € 48 to € 62. Our analysis of typical private household profiles, however, demonstrates that the tax burden for individual household can be very different. Thus, a typical pensioner would be impacted harder with an annual burden of € 118 to € 132. The burden from the FTT for private households would thus have covered approximately the monthly electricity costs of a 3-person household in 2012 in Germany, which amounts € 76.

Over a product lifecycle of a typical Riester savings plan[2] with an annual savings rate of € 803 (of which € 154 stems from a state allowance), the effect of the tax totals around € 7,600. The average annual pension is thus reduced from € 3,790 by € 380 per year to just € 3,410. In addition, the maximum state Riester-allowance of € 4,620 (without allowances for children) is completely consumed by the FTT.

FTT burden for companies in the real economy

Companies in the real economy will also be impacted negatively by the financial transaction tax. The total tax burden is estimated at € 2.4 to € 3.7 billion, resulting primarily from the use of derivatives, which are applied in order to hedge against fluctuations of exchange and interest rates. Even excluding derivatives for hedging commodity price risks the impact from FTT on companies' risk management is quantified at € 1.0 to € 1.9 billion annually. Corporate pension vehicles will be burdened with around € 0.7 billion per annum, because an essential part of the pension plans of employees is invested in taxable securities. Finally, approximately € 0.7 to € 1.1 billion in FTT burden results from the issuance of specific refinancing instruments (commercial paper and asset-backed securities) and other FTT related transactions (e.g. investments of liquidity management).

The FTT from companies in the real economy, even in the conservative scenario, corresponds to about two-thirds of the profits of all manufacturing enterprises in Hesse (Germany) or around 15 percent of Germany's total revenue from the corporate income tax in 2012.

Secondary effects on market liquidity and transaction costs

In addition to the direct effects, the financial transaction tax will significantly reduce the liquidity of the markets for securities and derivative financial instruments. The resulting lower liquidity increases transaction costs and thus leads either to higher financing costs for companies or a lower rate of return for retail investors.

For the trading of equities, bonds and derivatives we expect additional transaction costs of about € 2.0 to € 4.7 billion.

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2 A Riester savings plan is a government-subsidised private pension-saving product which has been created to promote private old age provision in Germany.

Further effects

There are further negative effects from the FTT concerning the availability of financial products, which are not the focus of this study. Assuming current common trading behaviour only, we estimate that the FTT stemming from the short-term liquidity supply of German financial institutions who utilise repurchase agreement transactions (repos) would add up to the almost unimaginable amount of € 69 billion annually. As a result the market would dry up, because repo transactions economically would no longer make sense under such conditions.

If banks, as liquidity providers for the economy, leave the money market, companies will not be able to cover their short-term credit needs or will have to pay much higher prices. Therefore, a shifting of the tax burden from financial institutions to the real economy can be expected even from transactions that are not directly related to a business customer.

A similar risk of illiquidity would result for the short-and medium-term bond markets, where the burden of the FTT will overcompensate the potential yield or the yield spreads over comparable bank deposits. The company would lose an additional important instrument of refinancing.

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