European Commission Consultation Paper

issued 22nd February 2011

by DG Taxation and Customs Union

A Response by the Futures and Options Association

APRIL 2011

FOA Response to European Commission Consultation Paper issued 22nd February 2011 by DG Taxation and Customs Union

The Futures and Options Association offers the following general observations on the consequences of a Financial Transaction Tax (FAT) in Part 1 of this response paper.

Detailed answers to specific questions from the 22nd February 2011 consultation are contained within Part 2 of this response.

PART I: OBSERVATIONS ON THE CONSEQUENCES OF A FINANCIAL TRANSACTION TAX

1. Introduction

1.1 The notion of a tax on financial transactions was first raised by John Keynes in 1936 when he suggested that *"The introduction of a substantial government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States"*.[1]

1.2 James Tobin, to whom the idea of a transaction tax is more frequently attributed, acknowledged that he was building on Keynes' proposal, but suggested a tax only on spot currency transactions. Following the collapse of the Bretton Woods system in 1971, Tobin was concerned that *"National economies and national governments are not capable of adjusting to massive movements of funds across the foreign exchanges, without real hardship and without significant sacrifice of the objectives of national economic policy with respect to employment, output, and inflation."*[2]

What Keynes and Tobin both have in common was a desire to limit what they perceived to be the negative impact of speculation on financial markets and the wider economy, while still encouraging long term, sustainable investment. What neither Keynes nor Tobin proposed was a method for raising revenue, since both intended the tax imposed to limit a certain type of activity perceived to be detrimental to the healthy functioning of markets.

1.3 At the core of these original proposals is the notion that speculation somehow undermines the purpose of financial markets, that speculators increase volatility without engaging in "socially useful" activity. Yet this opinion is not universal, and modern theorists increasingly express the view that, far from being detrimental for the smooth operation of financial markets, 'speculators' enhance liquidity, reduce volatility, improve price discovery and facilitate the risk transfer trades of commercial and institutional users of the markets.

1.4 In the aftermath of the recent financial crisis, the notion of a tax on all financial transactions, sometimes erroneously referred to as a Tobin Tax, has again become popular in some sectors. This has since created a priority focus on the introduction of a financial activities tax. Such a tax, it is felt, would serve the twin aims of discouraging

[1] John Maynard Keynes, "The General Theory of Employment, Interest and Money".

[2] James Tobin, "A Proposal for International Monetary Reform".

behaviour deemed likely to lead to a repeat of the crisis and raise funds to both recover the costs incurred by governments and protect against future financial turmoil.

1.5 The impact of a financial transaction tax would depend on *inter alia* the range of jurisdictions to which it was applied, the scope of implementation, the size of the tax, the ease with which it could be avoided (either through direct tax avoidance strategies or the migration of business to jurisdictions outside the tax) and the extent to which existing business models were able to adapt to accommodate costs.

2. Purpose of tax on financial transactions

2.1 Modern advocates of a broad tax on financial transactions have outlined a number of different goals:

- Discourage short term, harmful trading strategies which distort market prices and volatility, e.g. speculation;
- Recover the cost of financial bailouts during the recent crisis;
- Raise revenue to support buttress the financial system against future instability; and
- Raise funds for an assortment of social projects.

3. Liquidity, volatility and price discovery

3.1 The core argument for a tax on financial transactions, as proposed by both Keynes and Tobin, rests on the assumption that speculation is an inherently harmful activity which, amongst other things, increases volatility in the market and drives prices higher to the detriment of non-speculators.

3.2 The counter argument – which is supported by the majority of reports issued to date – suggests that, while speculative trading activities can generate short-term volatility bubbles and price spikes, these are more than offset by significant liquidity enhancement, smoothing out price differences and facilitating the risk-transfer needs of commercial and institutional end-users. The current Princeton Professor of Economics, Burton Malkiel recently expressed the view that *"high frequency traders are not villains—indeed, they play an important role in improving market efficiency. High-frequency traders scour markets for minor mispricings and arbitrage trading opportunities. They buy and sell stocks in an instant, hoping to earn pennies on a trade. Far from destabilizing or creating volatility in the market, their actions significantly increase trading volume, reduce spreads, promote price discovery, and ultimately reduce transactions costs for long-term investors. Such trades might not be doing God's work, but they are socially useful."*[3]

3.3 While some studies using theoretical models suggest that currency markets might experience reduced volatility following the introduction of a tax, other models suggest that sufficiently deep markets might experience no change in volatility, while less deep markets, including derivatives markets, might experience increased volatility following any significant change in liquidity.

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[3] Burton G. Malkiel, George U. Sauter "A Transaction Tax Would Hurt All Investors. The unintended consequences of the 'Let Wall Street Pay for the Restoration of Main Street Act'"

3.4 Studies using empirical evidence are limited as instances of the introduction of a transaction tax are rare. Some have noted that the early stages following adoption of a transaction tax see an increase in volatility corresponding with a fall in liquidity (Sweden), although these results are not universal. The weight of evidence appears to support the view that transaction taxes increase volatility, with a recent paper conceding that *"ten studies report a positive relationship between transaction taxes and short-term price volatility, five studies did not find any significant relationship"*.[4]

3.5 More general studies on the link between liquidity and volatility that do not deal directly with the consequences of a tax on transactions concur with the view that liquidity typically reduces volatility. While short-term volatility can be traced to high levels of speculative activity (particularly in smaller, more specialist markets), it can also be generated by regulatory intervention, e.g. the spike in volatility in equity markets in 2008 during the financial crisis following widespread bans on short selling.[5]

3.6 For many markets, in particular commodity markets, increased liquidity is an aid to price discovery. A greater number of market participants trading more frequently results in a market which responds rapidly yet smoothly to new data and changed expectations. Reducing the number of market participants, in particular high frequency traders, would limit the ability of the market to respond to new information and result in more abrupt changes in price. Such changes are likely to be detrimental to less sophisticated investors who suffer more from information asymmetries than larger or more experienced market participants.

4. Impact on financial markets

4.1 Empirical evidence supports the claim that markets will rapidly migrate from jurisdictions where tax is applied to transactions, although the rate of migration may depend on both the size of the existing market and the availability of alternatives.

4.2 Sweden introduced tax first on equities and subsequently on fixed income securities and then derivatives in the period between 1984 and 1991. This resulted in notable decline in trading volumes and prices in those markets. Bond market volumes fell by 85% in the first week of the tax even though the tax rate was a mere 0.003% on five year bonds, while futures volumes fell 98% and options trading effectively disappeared. By the end of 1991, the Swedish government had abolished the tax, after which point volumes gradually returned.

4.3 Advocates of a financial transaction tax point to the stamp duty imposed on the transfer of shares in the UK, together with the size of UK financial markets, as evidence that financial transaction taxes do not automatically result in migration where markets are sufficiently liquid. Significantly, the stamp duty (actually Stamp Duty Reserve Tax, or SDRT, in the case of most financial transactions) carries a specific exemption for 'qualifying intermediaries', a category which includes market makers and large banks. Consequently, many of the most mobile institutions have no need to relocate.

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[4] Stephan Schulmeister, Margit Schratzenstaller, Oliver Picek, "A General Financial Transaction Tax. Motives, Revenues, Feasibility and Effects"

[5] James Angel, Lawrence Harris, Chester Spatt, "Equity Trading in the 21st Century"

4.4 The argument is also made that a limited number of key jurisdictions currently account for a high proportion of global financial transactions, and that an agreement between a handful of governments to impose a tax would be sufficient to ensure that most significant venues were covered. In practice, a tax targeted at a limited number of jurisdictions, even those which are currently recognised as major financial centres, would be unlikely to prevent markets from migrating. The most recent Global Financial Centres Index[6] acknowledges that Hong Kong and Singapore are now considered to be close rivals of New York and London in terms of competitiveness by financial professionals. A total of five Asian jurisdictions now rank in the top ten, and all are tipped to become even more significant within the next few years even before any hypothetical transaction tax were applied to EU and US exchanges. The application of a financial transaction or activities tax by the EU and the US would, when taken together with all the other changes that are exacerbating the costs of financial activity in the EU and the US, almost certainly generate a significant outflow of business to Asia.

5. Impact on investors

5.1 One possible consequence of a financial transaction/activity tax would be the transfer of unavoidable costs to the end user, or at the very least to an intermediary. While competition among clearing members might mitigate this to an extent, some cost of the tax, even if indirect, would be passed on initially to corporate treasury functions and industrial users of commodities, and from there to employees, shareholders and customers.

5.2 Aside from those firms profiting directly from financial transactions, indirect targets of the tax would include pension funds investing via hedge funds and similar organisations which are often at the forefront of 'speculative' trading activities.

5.3 Even if direct costs were not passed on to other market participants, a tax which applies to all transactions would necessarily increase spreads and, in reducing participation from high frequency traders and others, lead to a decline in liquidity and increased transaction costs for the remaining participants. These too would ultimately impact the likes of pension funds and hence, indirectly, the public.

5.4 Barriers to entry for new firms would increase and smaller firms may be driven from the markets entirely. Restricting markets to a reduced number of larger participants increases systemic risk in the event of further market disruption. This is a particular risk in the event that tax rates are not correctly calibrated (see below).

6. Revenue generation and impact on corporate end users

6.1 The potential value of a transaction tax is twofold – it could discourage trading activity considered harmful and it could raise revenue, although these two objectives are, to an extent, mutually exclusive, i.e. increased revenue would be at risk of not achieving any revenue projections because of a decline in the underlying business, or losses in direct corporation tax on the profits of banks and other market participants and reduced activity by end users.

[6] GFCI 6, September 2009

6.2 A financial transaction tax is envisaged as a tax on the notional value of a given transaction and not on any direct profit arising. Market participants variously derive income from direct profits on transactions, from fees and commissions charged to clients, and from interest or other income on client margins deposited gross with a firm but paid net to the clearing house. These revenue streams all require either that the underlying transaction remain sufficiently profitable for the end user one all fees and similar costs are taken into consideration, or else that the net cost incurred is deemed small enough when weighed against the benefits from the transaction (as with trades undertaken from the purpose of hedging or corporate treasury functions).

6.3 A tax which is calibrated above the level of direct profit on the transaction itself, such as the currently 'Robin Hood Tax' proposals in the UK[7] suggesting a tax of 0.05% of notional value (compare with the 0.003% rate on Swedish bonds noted above) on transactions where the actual profit may be measured in a handful of basis points will remove any incentive for high frequency traders to participate in a given market. This is directly in line with the objective to reduce speculation in financial markets, but the consequence would be increased spreads and an increase in transaction costs for end users as those remaining in the market attempt to recover lost revenue and/or cover their own increased costs. The consequence for corporate end users in this case would be the twofold increase in costs from both the tax itself and the subsequent increase in costs for their own hedging and treasury activities.

6.4 The danger for the wider economy is therefore that non-financial institutions would find more of their own resources tied up in meeting the cost of the financial transaction tax. "Transactions taxes would make most current high-frequency trades unprofitable since they depend on the thinnest of profit margins. Trading volume would collapse, and there would be a dramatic shortfall in the tax dollars actually collected by the government. Market liquidity would decline, bid-offer spreads would widen, and all investors would pay significantly higher costs on their trades".[8]

6.5 It is likely that corporations could well scale back on their own risk management activities to the extent that the introduction of any such tax would add to the already significant cumulative cost burden faced by them in meeting the "pass-on" costs of their regulated counterparties, potentially higher and more frequently-called margin, tighter collateral rules and exacerbated clearing costs. This could result, in turn, in a significant exacerbation in the market risk generated by their unhedged underlying commercial activities.

6.6 A tax which is set sufficiently low as to ensure that financial transactions remain directly profitable in themselves would necessarily fail to provide revenue on the scale intended.

6.7 But could firms avoid the tax by altering trading activities? Studies by the IMF[9] suggest that applying a different level of tax to different activities would encourage traders to rapidly develop more tax efficient trading strategies, even when a particular exposure to a given market was required, thereby minimising the returns of the tax.

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[7] www.robinhoodtax.org.uk

[8] Burton G. Malkiel, George U. Sauter "A Transaction Tax Would Hurt All Investors. The unintended consequences of the 'Let Wall Street Pay for the Restoration of Main Street Act'"

[9] Karl Habermeier, Andrei Kirilenko, "Securities Transaction Taxes and Financial Markets"

6.8 In any event, the returns from the tax are likely to be far lower than anticipated, whether as a result of disruption to market activity, migration of business to non-taxed jurisdictions or simple adaptation of trading activity away from the most heavily taxed trades. At the same time, the consequences on corporate users of financial markets, which have hitherto been overlooked by proponents of the tax, must be considered.

7. Impact on wider economy

7.1 Where pension funds and corporate users of financial markets are impacted by a financial transaction tax, the ultimate consequences will be felt by the public. In response to the recent proposals in the US, Professor Malkiel noted that *"Wall Street would not foot the bill for the presumed $150 billion tax. In fact the tax would be added to the cost of doing business, burdening all investors, including 401(k) plans, IRAs and mutual funds"*[10]. In this context, it is well to remember that it is important not to exacerbate business costs unduly, insofar as the underlying objectives behind the imposition of a financial transaction or financial activity tax should not damage the equally important objective of delivering post-crisis economic growth.

7.2 The overflow into supporting industries may be hard to measure. One study of the impact on a limited transaction tax applied only to New York[11] examined the extent to which the multiplier effect of job losses and reduced productivity in the financial sector within New York would reduce both tax revenue and demand for other services. The Conclusion was that a 10% reduction in financial sector employment would result in a 1% reduction in the retail, services and restaurant sectors, a 4% reduction in the business services sector, and a 1% reduction in other private sectors. The same study estimated that a 10% decline in stock market volumes in New York could therefore result in 30,000 to 40,000 job losses within the city.

PART II: RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you consider it justifiable that the revenue side of fiscal consolidation efforts of Member States are targeting the financial sector?

1.1 The FOA notes the widespread public antipathy towards the financial sector and the pervading belief that the financial sector, particularly the banking sector, was responsible for the financial crisis and the resulting recession. The fact is that there were many sectors, including governments in terms of their housing policies and pro-cyclical spending, irresponsible borrowing (alongside irresponsible lending) that contributed to the crisis. The FOA would add that political and regulatory initiatives that are spurred primarily by public opinion and political populism are at serious risk of distorting the marketplace and imposing greater costs on the end-users of financial products and services, ultimately that same public and impairing activities necessary to delivery post-crisis economic recovery, i.e. choice, diversity and cost, in terms of raising capital, managing risks and investing.

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[10] Burton G. Malkiel, George U. Sauter "A Transaction Tax Would Hurt All Investors. The unintended consequences of the 'Let Wall Street Pay for the Restoration of Main Street Act'"

[11] Jonathan A. Schwabish "Estimating Employment Spillover Effects In New York City with an Application to The Stock Transfer Tax"

1.2 Clearly, the objectives of any fiscal policy which targets the financial sector must be clear, evidenced and deliverable if that policy is to be properly justified. There are apparently three potentially conflicting objectives behind the proposals for new financial sector taxes:

1) Punish financial institutions for their role in the crisis

2) Discourage behaviour which could lead to another financial crisis;

3) Establish a fund to cover the cost of future bail outs; and/or

4) Generate additional revenue to support government spending during the current recession.

Punishing financial institutions

1.3 If the objective is to punish banks, FOA regards it as highly questionable that any retribution (as opposed to deterrence) is an acceptable public policy reason for imposing taxes to the point where it could be regarded as a wholly unreasonable use of governmental authority.

Discouraging unacceptable behaviours to avoid generating a further crisis

1.4 The FOA believes that the imposition of a tax designed to discourage high risk activity in the future must be properly evidenced as a "deliverable" and should avoid unfairly penalising market participants who were not directly linked to the crisis or alter behaviours which functioned well during the crisis. Further, it is essential that the need for such a tax is measured against the additional capital requirements and other regulatory incentives designed to achieve this same objective. Unnecessary duplication could not only be unduly expensive, but could impair market transparency and liquidity, which have been accepted as key problems during the crisis. The potential for taxes to reduce liquidity should not be underestimated.

Establishing a fund to cover the cost of future bailouts

1.5 The FOA is not convinced that this is now a required objective, insofar as the risk of the occurrence of future bailouts has been substantially mitigated by a whole range of regulatory and capital measures, ranging from new resolution frameworks, countercyclical capital rules, powers of regulatory intervention and new macro-supervisory structures, all of which, in the view of the FOA, make this an unnecessary objective. Further, it is necessary to determine which institutions might benefit from such a fund and, secondly, ensure that, in the interests of fairness, firms which would not be direct beneficiaries are not obliged to contribute to the fund. Broad-based taxes are likely to have a disproportionate effect on smaller firms which are not typically regarded as systemically important. Further, the clear indications are that both the US and UK governments (and, therefore, the taxpayer) will ultimately profit from contributions made to support national financial services industries (and that is borne out historically), which raises fundamental questions as to the need for any such central fund. Even if a net cost remains, it is not clear why any relief fund should greatly exceed this final cost, and hence why contributions from the financial sector should be required in perpetuity.

Generating additional revenue to support government spending

1.6 The FOA believes that this could be a damaging transfer from the private sector to the public sector, in terms of providing services to the taxpayer, i.e. additional revenue to governments will reduce the capacity of the private sector, particularly banks, to fund post-crisis recovery through facilitating the raising of capital / lending, and returns on investment performance, etc. at a time when this is most needed.

Q2: Do you find it problematic that Member States introduce patch-work national measures without coordination?

2.1 Where member states are in agreement as to the appropriate legislative action it is advantageous for that legislation to be introduced as uniformly throughout the EU as possible so as to minimise unintentional arbitrage opportunities. As against that, regulatory consensus should not be bought at the price of excessive or punitive rules or rules/process which distort market functionality. Further, consensus may not actually be achievable for all sorts of nationalistic or economic reasons. In such circumstances, national flexibility has a significant part to play in the delivery of realistic and deliverable financial services rules and processes.

2.2 The FOA would point out that the economic implications of a uniform pan-EU approach to taxation will be extremely difficult to achieve what are fundamentally very different economies, political priorities and governmental structures.

Q3: Do you consider that shortcomings in the governance or behaviour of financial markets or financial institutions were one of the major reasons for the financial and economic crisis?

3.1 The FOA believes that "financial institutions and financial markets" is too broad a category to comment on meaningfully in this context. While it might be argued that there were specific governance failings in specific financial institutions concerning certain specific financial products, we do not believe that this can be fairly attributed to financial markets, nor to the vast majority of financial institutions, nor in relation to the vast majority of financial products. Indeed, the great majority of institutions and markets were as much victims of the crisis as any other sector. Further, certain features of the financial services sector, for instance the remuneration culture, while it is the subject of public concern as to the size of some bonuses and can impact on risk appetite, it has not be identified as a significant contributory factor to the crisis, notwithstanding the widespread attention that remuneration has received.

3.2 The FOA believes that any attempt to address the causes of the financial crisis should be more tightly focused than a measure which targets entire markets or categories of institution.

Q4: Which sectors and activities within the financial sector had to do most with the crisis?

4.1 The FOA believes that much of the blame for the crisis can actually be fairly apportioned between some (not all) key banks – alongside governments, in terms of their pro-cyclical behaviours/spending and the adoption of ill-advised housing policies, as well as irresponsible spending in the High Street. It follows that the FOA does not believe that it is fair or just to hold particular sectors culpable when there was a collective attitude towards both lending and spending during a period of "easy money". That said, the programme for financial repair has targeted many of the elements that gave cause to the crisis in the financial sector and therefore does not believe that it

would be appropriate to introduce punitive fiscal measures for the reasons set out early in this response.

Q5: *Do you consider those shortcomings in the governance or behaviour of financial markets or financial institutions to be an EU-wide problem?*

5.1 Again, this question presupposes that there are noteworthy shortcomings in governance and behaviour across markets or institutions. The FOA contests this supposition.

Q6: *Do you consider the financial sector in the EU to be under-taxed (e.g. because of VAT exemption, exemption from thin capitalization rules, higher economic rent i.e. excess profits) or overtaxed (e.g. because of special additional taxes already implemented) with respect to other sectors of economic activity?*

6.1 The FOA notes as a point of interest that the VAT exempt status of many financial sector activities is often cited as evidence that the sector is under taxed. Where an activity or service is exempt from VAT, the input VAT tax burden is born by the firm concerned. This is the case with much of the financial sector. Where an activity is subject to VAT, the input VAT cost to a firm can be offset by the output VAT collected from customers. In consequence, changing the VAT exempt status of certain financial services could increase the ultimate tax take but at the cost of end users of financial services rather than the providers. While the actual VAT arrangements of a given firm are likely to be more complex than this, it is inaccurate to assume without a more detailed review that the changing the VAT status of financial services would increase the cost born by the financial sector relative to other market users.

6.2 Beyond this observation the FOA has no comment on the relative level of tax paid by the financial sector.

Q7: *Which sectors and/or activities within the financial sector do you think are most undertaxed/over-taxed?*

7.1 No comment.

Q8: *What do you think of tax measures, versus regulatory measures and levies (connected to the financing of funds to ensure the proper resolution of financial institutions)?*

8.1 The FOA has responded largely unfavourably to the concept of additional tax for reasons already stated.

Q9: *Do you consider that an FTT or an FAT could lead to cumulative social and economic effects in combination with any of the ongoing regulatory reforms in the financial sector, including the banking levy (see COM 2010(301)final)4?*

9.1 Notwithstanding specific responses to questions below, the FOA believes that the addition of such a tax would generate a decline in financial activity because of relocation or a shift in the cost-benefit economic analysis of such activity to the social and economic detriment of those jurisdictions that seek to impose such taxes and, as

already stated, the FOA does not believe that the programme of regulatory reform makes any such tax necessary.

Q10: At what level do you think that the FTT will be most effective?

10.1 The experience of countries which have introduced tax schemes similar to the FTT demonstrates shows the speed at which certain activities can and will relocate to avoid taxation.

10.2 The Swedish transaction tax introduced in 1984 saw transaction levels fall by 85% on five year bonds in response to a transaction tax rate of only 0.003%. Tax on derivatives saw volumes fall by 98%. Although volumes gradually recovered once the tax was abolished in 1991, recovery did not restore the full level of lost trading. While some proponents of transaction taxes point to the example of the UK Stamp Duty as evidence that established financial centres are not unduly affected by such taxes, it is important to consider that the UK tax includes an exemption for "qualifying intermediaries" i.e. the banks and other financial firms intended to be the target of any proposed FTT.

10.3 On the basis of examples such as that, an in a world where the relocation of trading business is easier than ever before, the FOA does not believe that a tax levelled at the EU level would be effective.

10.4 The efficacy of a global level tax depends greatly on the purpose for which the tax is intended. If the aim is to raise revenue then the FOA believes that even a small tax based on the value of the underlying would have a significant impact on liquidity and price volatility in a great number of markets. Once exchange fees and other associated costs are included, the profit on a given transaction can be less than even the small tax level proposed. It is therefore likely that a FTT imposed at a global level so as to prevent the relocation of trading activities would still fail to produce the anticipated revenue simply because many of the transactions that policy makers anticipate taxing would no longer take place to be taxed.

10.5 In terms of the objectives listed above (Q1), the FOA does not believe that any revenue raising objective could reasonably be met through the introduction of a FTT. While the tax might limit certain trading activity (at a potentially severe cost in volatility and liquidity), it is important to note that the volume of exchange based trading activity has never been identified as a cause of the financial crisis. A FTT, if introduced with the aim of reducing trading volumes, would be pursuing a political agenda beyond merely responding to the recent crisis.

Q11: Do you think that a broad based financial transaction tax is a viable instrument?

11.1 No, for the reasons already set out in this response. In any event, the FOA believes it is essential that there is global "buy-in" to any such tax and that, prior to its introduction, there should be a full market impact / cost-benefit analysis, covering particularly the impact of reduced financial activity, both socially and economically, the risk of business arbitrage, the potential for a decline in market liquidity and whether such a tax will be addressing a risk that is not adequately already addressed in the programme for financial repair.

Q12: What do you consider as an appropriate connecting factor for the place of levying of the tax?

12.1 The FOA does not believe that such a tax is appropriate.

Q13: Do you think that the value set for the underlying is (in general) a correct tax base for derivatives?

13.1 No. The profit on a given transaction is not proportional to the value of the underlying, so a tax calculated with reference to the underlying would not remain constant in relation to the profit and effective tax rates could vary considerably.

Q14: Do you consider that there would be a risk of financial engineering around the broad-based or narrow-based FTT that would undermine the objectives of the measure?

14.1 From a practical point of view the extent of financial engineering would depend greatly on the details of the tax legislation, but it is highly unlikely that legislation drafted at either a global or even EU level for either a broad-based or narrow-based FTT would be sufficiently flexible to match the pace of financial innovation. Either by intent or by accident, newer financial products or alternative financial services would rapidly emerge which would fall outside the scope of the tax.

Q15: What do you think of the FTT designed as a cumulative tax, i.e. every subsequent sale is taxed at the full amount of the transaction without any deduction of previously paid FTT?

15.1 The FOA notes that the suggested answers to this question imply that the aim of the tax is to target short-term speculative trading. The paper does not explain why this is considered a worthwhile objective, nor does it set out any evidence as to why it would be appropriate. Short term trading is essential to provide liquidity to markets which in turn reduces volatility, limits the opportunities for price arbitrage, enhances price discovery and facilitates risk transfer.

15.2 We further note that the apparent desire to limit short-term trading volumes is inconsistent with any intention to raise revenue via a FTT as no tax can be levied on trades which do not take place.

Q16: Would there be a need for specific exemption of certain transactions from the FTT or an exemption threshold?

16.1 No comment.

Q17: Do you think FTT rates should be differentiated depending on the type of product traded?

17.1 The FOA does not accept that a FTT is appropriate in the first place.

Q18: Do you think that the tax incidence of the tax will fall on the financial sector, or will it be shifted to the customers?

18.1 Regardless of the intent of legislators, it is inevitable and historically justified that the burden of the tax will ultimately be passed on to customers in one form or another. Even assuming that the direct costs are not passed on, the negative impact that the tax would have on market liquidity would necessarily result in increased exchange fees and wider spreads, which would in turn disadvantage all market users and not simply

the financial institutions. Neither would the impact of the tax be limited to direct users of financial markets. Increased transaction costs would reduce the returns generated by pension funds, for example, and so extend beyond direct market participants into the wider economy.

Q19: What do you think of the administrative costs related to the broad-based FTT? Do you think that it would be the same for a narrow-based FTT?

19.1 No comment.

Q20: What do you think of the effect on employment from broad-based FTT? Do you think that it would be the same for a narrow-based FTT?

20.1 The FOA believes that the additional costs imposed as a result of an FTT would have to be compensated at some time, either by reduced employment by institutions impacted by an FTT or by passing on the charges to customers. At a time of intense regulatory repair and increased regulatory costs, it should not be assumed that this is yet another cost that is capable of being absorbed by financial service providers.

Q21: What do you think of the effect on small and medium enterprises (SMEs) from broad-based FTT? Do you think that it would be the same for a narrow-based FTT?

21.1 The FOA does not believe it is appropriate to apply such a tax in the first place, and certainly not to small and medium-sized enterprises which are seeking to rebuild their businesses and capital as part of their programme for post-crisis recovery.

Q22: At what level do you think that the FAT will be most effective?

22.2 The FOA has no comments on the FAT.