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# THE COLUMBIA JOURNAL OF EUROPEAN LAW ONLINE

## THE EUROPEAN COMMISSION'S FINANCIAL TRANSACTION TAX AND BETTER LAWMAKING

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### I. Introduction

Financing the European Union (EU or Union) appears to be the next hot topic of debate for the EU's Member States. A financial transaction tax (FTT), which is a tax placed on the transactions of stocks, bonds, and derivative products,<sup>2</sup> is one of the proposed financing options. As proposed by the European Commission (Commission), financial institutions, on both sides of the transaction, would be liable for this tax. The Commission has suggested a 0.1% tax rate for the transactions of bonds and shares and 0.01% for derivative products, and some Member States have already agreed to this proposal.<sup>3</sup> Under the proposal, Member States are supposed to contribute two-thirds of their nationally-collected FTT revenue to the EU budget.

The European Council, consisting of heads of states and the President of the European Commission, accepted the Commission's plan for the EU budget 2014-2020 on February 8, 2013. However, the Council left the FTT proposal open for further discussion.<sup>4</sup> 11 of the 27 EU Member States have already approved the FTT, but the tax does have fervent opponents like the United Kingdom.

This paper is an attempt to assess the proposed tax from the point of view of the EU's "Better Regulation" agenda. "Better Regulation is a broad strategy to improve the regulatory environment in Europe" by, among other methods, "improv[ing] the quality of new legislation by better evaluating its likely economic, social and environmental impacts."<sup>5</sup> The article asks whether the FTT adheres to the Commission's standards as stated in the Inter-Institutional Agreement on Better Lawmaking.<sup>6</sup>

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<sup>2</sup> European Commission, Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC, Brussels, 28.9.2011, COM(2011) 594 final.

<sup>3</sup> European Commission, Taxation and Customs Union, [http://ec.europa.eu/taxation\\_customs/taxation/other\\_taxes/financial\\_sector/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm).

<sup>4</sup> European Council, Conclusions (Multiannual Financial Framework), EUCO 37/13, Brussels (8 February 2013).

<sup>5</sup> European Commission. What is better regulation?, [http://ec.europa.eu/governance/better\\_regulation/br\\_what\\_en.htm](http://ec.europa.eu/governance/better_regulation/br_what_en.htm).

<sup>6</sup> European Commission, European Parliament and Council of Ministers, Inter-Institutional Agreement on Better Lawmaking, OJ 2003 C 321/01.



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## II. The EU Budget

Budgetary considerations have played an important role in the history of the EU. One of the main controversies was and still is about whether the EU should have its own resources. The Treaty of Rome (Treaty), signed in 1957, envisaged a transition period lasting until 1970 during which the EU's financing consisted of Member States' contributions. According to Article 201 of the Treaty, a system of "own resources," or self-financing, was to be introduced at the end of the transition period. From 1980 onwards, the Union had three sources of self-financing: (1) tariffs on manufactured imports from non-Member countries, (2) levies on agricultural imports from the rest of the world, and (3) a share of the total Value Added Tax (a broadly based consumption tax assessed on the value added to goods and services) levied by the Member States. However, in 1988, due to increasing free trade and the subsequently lower tariffs, as well as rising expenditures, the Union introduced a fourth source of revenue: a share (currently at 1.05%) of the Gross National Income (GNI) of each State. Today, contributions that are mobilized through the fourth source account for 75% of the total revenue of the EU, which runs counter to the philosophy behind the Treaty. Hence, reform of the EU's revenue generation mechanisms has become central to the debate about the future of the EU budget.<sup>7</sup> The proposed FTT is at the core of this debate, as the tax would cut the Member States' GNI-based contributions.

## III. The EU's Better Regulation Principles and the FTT

According to the European Commission, European Parliament, and the Council of Ministers, the quality of lawmaking within the Union depends on the quality of the legislative process. The most relevant factors in determining and measuring quality are how the social process and its related content are guaranteed: did all affected parties participate in the legislative process, and if so to what extent were their expectations fulfilled? Consideration should also be given to the economic, social, and environmental impact of a proposed law. An impact assessment is essential for a major policy proposal to be weighed effectively with a knowledge-based approach and alternatives to regulation to be examined as appropriate. Finally, the Commission is obligated to take into account both citizens' and corporations' views under the Better Regulation agenda.<sup>8</sup>

### (A) Visibility

Over the years, the Union has evolved from a bond between states to a cooperation between the Union and its citizens. An EU tax is supposed to establish a visible link

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<sup>7</sup> Senior Nello, S. *The European Union: Economics, Policies and History* (2012).

<sup>8</sup> European Commission, Better Regulation, [http://ec.europa.eu/governance/better\\_regulation/index\\_en.htm](http://ec.europa.eu/governance/better_regulation/index_en.htm).



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between the two.<sup>9</sup> However, studies show that the FTT, as an implicit tax, lacks visibility to EU citizens.<sup>10</sup> Rather, the FTT is visible only to corporations.

Additionally, the FTT's proponents gave two decisive reasons in favor of the tax – (1) the *responsibility* of the financial sector for the financial crisis of 2008 (akin to the so-called “polluter pays principle” in environmental law); and (2) high *popular support* from citizens for the idea that the financial sector should pay – that have nothing to do with visibility. In short, these reasons are probably just *ad hoc* populist criteria that should never serve as rationale for EU policies.

### **(B) *Juste retour***

Another important reason for the Union to introduce an EU tax is to counter the *juste retour* behavior of the Member States: States tend to favor expenditures that improve their net national benefits, rather than those with the greatest value added for the EU as a whole. Such purely self-interested behavior has been shown to be the result of the dominant way for financing the EU – with national, GNI-based contributions. This method of financing “places disproportionate emphasis on net balances between Member States[,] thus contradicting the principle of EU solidarity, diluting the European common interest and largely ignoring European added value.”<sup>11</sup> Is *juste retour* behavior to blame for its supposed negative affect on the EU budget, though?

The history of the EU budget shows that national net interests, not solidarity, made the formation of the Union in 1957 possible. From that point until the late 1960s, it became institutionalized practice for Member States to plant national flags on EU expenditures and to attempt to strike a balance between their contributions to and the expenditures of the EU. It was generally accepted that if not for this behavior, the States involved would not have been able to come to any agreement. As history demonstrates, the EU budget does not facilitate solidarity between the States at all.

Therefore, the Commission should not contest the *juste retour* behavior of the States. “It is not the business of the science of public finance and of tax legislation to do away with the egotism of the social classes, but to assign it its proper place as a safeguard of legitimate particular interests,” said the economist Knut Wicksell.<sup>12</sup> He argued for a system of earmarked taxes and expenditures. Surprisingly, and probably *nolens volens* for

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<sup>9</sup> European Commission, Commission report on the operation of the own resource system, 505 final (2004); European Parliament, On the future of the European Union's own resources (2006/2205 (INI)), Rapporteur A. Lamassoure (2007).

<sup>10</sup> Begg, I., H. Enderlein, J. Le Cacheux, & M. Mrak, Financing the European Union Budget. Brussels: European Commission (2008); Cattoir, P., ‘Tax-based EU own resources: An assessment.’ Working Paper no.1. European Commission (2004).

<sup>11</sup> European Commission, A Budget for Europe 2020, Brussels, 29.6.2011, COM(2011) 500 final.

<sup>12</sup> Wicksell, K., *Finanztheoretische Untersuchungen* (1896) (Nabu Public Domain Reprint, 2010).



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the Commission, letting the financial sector pay for past or future financial crises<sup>13</sup> is in line with the thinking behind *juste retour*. In short, the FTT, *mutatis mutandis*, essentially puts the EU back to where it was in the first ten years of its existence.

### IV. Conclusion

How does the FTT score from the point of view of the Better Regulation agenda? First, it certainly is not a visible tax. If visibility is not improved, then the present GNI-based contribution system should be allowed to continue as is; this system is seen as a simple and fair way of financing. Second, the FTT is an earmarked tax. This contradicts the goal of the Union to fight *juste retour* behavior. In the past, however, the *juste retour* principle has proven to be a workable strategy. In sum, there is room for improvement in molding the Financial Transaction Tax.

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<sup>13</sup> European Commission, Executive Summary of the Impact Assessment, Brussels, 28.9.2011, SEC(2011) 1103 final.