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The Financial Transaction Tax:

Forerunner of European Integration and Fragmentation

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The European Commission backed the plan of eleven EU member states to push ahead with the Financial Transaction Tax (FTT) via the enhanced cooperation procedure. To find agreement among 28 member states on an issue often proves to be too difficult. The FTT is the third policy issue that uses the enhanced cooperation procedure that was established under the Amsterdam Treaty.[1] Recent policy issues such as Schengen, the Fiscal Compact, European Monetary Union (EMU), eurozone membership, as well as the progress finally achieved in establishing a European patent, all demonstrate that differentiated integration has become a European reality.

Jacques Delors' recent call for enhanced cooperation underscores the relevance of the procedure as an integration instrument of the future.[2] Enhanced cooperation is one of the most extreme forms of differentiated integration because it can also be created outside the EU treaties and implementation depends only on a minimum of nine member states and is accessible to non-members. Yet is the EU ready for this new wave in policy-making?The controversial FTT illustrates a highly political and ideological agenda, which will have extensive consequences for tax harmonisation on a European and even global level, but also for European integration. The more frequent usage of the enhanced cooperation procedure may raise questions about the coherence of the internal market and call for a redefinition of the perspective on differentiated integration, but also on opting out, since the two are not entirely the same.[3]

1. The other two policy issues are the divorce rules [Council Regulation (EU) No 1259/2010 of 20 December 2010, implementing enhanced cooperation in the area of the law applicable to divorce and legal separation L343/10, 29 December 2010]; and the European patent.
2. Jacques Delors, « *En Europe, il faut le pompier mais aussi l'architecte* », *La Croix*, 14 October 2012.
3. Opt-outs are defined under primary law and spell out which state accepts voluntary exclusion, thus implying that it is not open to everybody at all times. Enhanced cooperation, however, depends on the willingness of member states.

Many even fear the emergence of a '*Europe à la carte*'. This Policy Brief will first present a brief overview of the current FTT proposal. Second, public goods theory will be used to show the fragmentary nature of the FTT, as well as its impact on European differentiated integration. Third, the consequences of opting out and the 'integration dilemma' that member states face will be considered, with subsequent conclusions and recommendations.

From Swedish failure to Franco-German priority

The FTT process accelerated within the EU because of German support. In June 2012, German Chancellor Angela Merkel required the vote of the social democrat SPD to pass agreements in the German Bundestag on the European Stabilisation Mechanism (ESM) and the Fiscal Compact. In return, the SPD demanded active support from the government for the FTT.

A draft directive on the FTT[4] is currently under consideration, to be introduced by 1 January 2014 by eleven member states (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain). The draft directive envisages a 0.1 per cent tax on bond and share sales and a 0.01 per cent tax on sales of other financial products. According to impact assessments by the European Commission, such an FTT will probably generate € 30–50 billion per year. According to the Commission, the main goals of the FTT are to:

- Harmonise similar national tax measures in this area that already exist in ten EU member states.
- Compel the financial sector to pay its fair and substantial share to cover the cost of the recent crisis.
- Discourage high-frequency trading that does not help the real economy.

However, many member states contest a European FTT, mainly because of the risk of hindering economic growth and the danger of the financial sector relocating.[5] Financial institutions that are party to a transaction and are resident in one of the EU member states will be subject to taxation, or where there is a clear link between a party to the transaction or the financial product and one of the eleven member states that are instituting the FTT. As a result, a financial institution may have a strong incentive to move to a non-FTT country in order to avoid this form of taxation. In the 1980s Sweden unilaterally introduced an FTT, which directly led to financial institutions relocating to surrounding countries. The enhanced cooperation procedure might thus result in intra-EU relocation of financial institutions. However, France and Italy have already unilaterally implemented some form of an FTT, although the jury is still out on any potential negative consequences. Moreover, there are cases of the successful introduction of FTTs in G20 countries such as the United Kingdom (stamp duty), South Korea, Brazil, India and South Africa.[6] It should be noted, however, that these forms are not as all-encompassing as the EU's current plan.

Opponents argue that the FTT introduces harmful tax competition instead of eliminating it. It can even be debated that the distorting competition among member states undermines the internal market, which would be at odds with the Treaty provision on enhanced cooperation.[7] The non-participating United Kingdom has even filed a complaint before the European Court of Justice, because UK financial firms that trade with an institution based in an FTT member state will still be taxed. According to the UK, this violates EU law and is inconsistent with international tax norms.

4. *Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax*, COM(2013) 71 final, Brussels, 14 February 2013.
5. For an extensive overview of economic and political arguments, read: Oultremont, C. d' and A. Mijs (2013), *Reforming the System of Financing the EU Budget*, The Egmont Institute, Working Paper, February 2013.
6. Griffith-Jones, S. and A. Persaud (2011), *Financial Transaction Taxes*, study commissioned by the European Parliament.
7. Art. 326 TFEU.

More recently, the Council of Ministers' legal service even considered the FTT to be incompatible with EU law, because it surpasses member states' exclusive power over taxation under international law.[8] The negative economic impact would only be limited if the FTT was implemented on a global scale, as was France's idea from the beginning. France wanted to introduce the FTT via the G20, but it did not muster enough support. However, many of the negotiating EU member states still regard the FTT's introduction in Europe as a stepping-stone towards global implementation.

Differentiated integration is here to stay

From a broader scope on EU unity, differentiated integration marks the beginning towards a dispersed EU that is categorised in functional, sector-specific regimes. The FTT will probably not be the last contentious proposal put forward by a minority of member states via the enhanced cooperation procedure. The procedure will probably be launched more frequently in the future because the 'EU expands geographically, continues to introduce new policies and struggles with Eurosceptic populations'[9]. Differentiated integration contains examples in specific policy areas such as the euro, the Stability Treaty, and Schengen. The durability of opt-outs, unwillingness to join, possible participation of non-member states, and the development of instruments such as the enhanced cooperation procedure display a lasting character of differentiated integration in the EU, which makes it a timely subject for debate. The cases of the FTT and tax harmonisation in general, but also other policy areas such as economic governance, demonstrate a trend towards differentiated integration. The EU and its member states therefore have to adapt to this expanding phenomenon.

Enhanced cooperation reflects the European integration model of variable geometry. Thus far, there are different models of European integration based on differentiation criteria, including the time dimension, functional versus territorial, within versus outside the treaties, member states and non-member states.[10] At the moment, the theoretical model of a two-speed or multiple-speed Europe most resembles the current EU. Here, differentiation is purely temporal,[11] relates only to member states, and is implemented inside the European treaties. Enhanced cooperation, meanwhile, is a tool in the variable geometry model and is characterised by the aim of establishing functional regimes with sector-specific differentiation. It affirms the willingness of certain states to advance on a particular topic. Primary law defines a framework, but it does not identify the policy areas of application in advance. It can therefore also be established outside the treaties and non-members are able to participate at a later stage. This is explicitly the ambition of the FTT, since it would work best when the tax is implemented on a global scale. However, non-EU members are not currently involved in any way in the legislative procedure.

How likely is it that the FTT will develop towards a common EU policy? Public goods theory suggests that EU unity in the longer term will be unlikely in the case of the FTT. According to Kölliker,[12] it depends on the nature of a policy, the type of good, and what the likely long-term consequences are.

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8. Council of the European Union (2013), *Opinion of the legal service on the proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT)*, Interinstitutional File: 2013/0045 (CNS), Brussels, 6 September 2013.
9. Adler-Nissen, R. (2011), 'Opting Out of an Ever Closer Union: The Integration *Doxa* and the Management of Sovereignty, in: *West European Politics*, 34(5): 1092–1113 at p. 1094.
10. Holzinger, K. and F. Schimmelfennig (2012), 'Differentiated Integration in the European Union: Many Concepts, Sparse Theory, Few Data', *Journal of European Public Policy*, 19(2): 292–305.
11. Presupposing eventual EU unity at a certain point in time.
12. Kölliker, K. (2001), 'Bringing Together or Driving Apart the Union? Towards a Theory of Differentiated Integration', in: *West European Politics*, 24(4): 125–151.

Certain goods generate centripetal effects – that is, incentives for outsiders to join at a later stage. Others may have centrifugal effects, or incentives to remain autonomous, making member states less likely to adopt the policy at a later point in time. Kölliker categorises tax harmonisation, under which the FTT falls, as a common pool resource (CPR), which mainly produces centrifugal effects.With a CPR, the positive external effect for outsiders tends to be higher than the positive internal effects for insiders. The EU dossier of taxation on savings displays the same characteristics as the FTT:

1. Consumption is rival (governments are unable to tax all at once).
2. Excluding non-cooperating countries and jurisdictions from benefits poses enormous difficulties.
3. Increased tax revenues for cooperating governments may easily leak to non-cooperating countries (that is, tax havens).[13]

The European Council of 2000 in Santa Maria da Feira, Portugal, insisted on the participation of all member states and wanted equivalent measures in potential and actual tax havens (such as Switzerland, Liechtenstein and Monaco) beyond EU borders.[14] However, this framework is still under negotiation with the third parties concerned, because of their reluctance to cooperate. In the case of the FTT, this coincides with the danger of financial businesses relocating. Some EU member states might even reap the benefits of non-participation via these relocations. If every member state makes a national consideration, this results in small alliances, with fading common ground at the EU level. After economic crises in particular, member states are prone to think in terms of national net balances. This makes an EU-wide vision and unity, where broad cooperation is the basis of its added value, unsustainable.

Functional, sector-specific regimes in many instances call for an assessment of the current institutional architecture of the EU. For example, the Eurogroup has emerged as the *de facto* decision-making body in the Council on financial issues concerning the euro. Non-eurozone countries are affected by its decisions, but feel that they are losing influence in the Council. The counter-argument is that these member states themselves decided not to join the eurozone. Another institutional aspect concerns voting rights in the European Parliament. There are calls for a eurozone parliament where only MEPs whose national government has introduced the euro are eligible to vote. This could account for matters concerning the eurozone, but also for the FTT and other policy areas.

Opting out: business as usual?

Opt-outs signal a more widespread trend that member states only apply policies that are potentially beneficial.[15] Non-participation in enhanced cooperation is not identical to an opt-out, but opt-out theory and the consequences for member states do apply.

Opting out might negatively affect a country's position as a coalition partner. With the enhanced cooperation procedure, however, a member state can participate in the policy-making process, but it does not have a formal voting right. Consequently, in practice it might be excluded from the decision-making process.

A more constructive and influential approach would be for a member state to position itself as a coalition partner that is in agreement provided that certain terms are to be met.

13. Kölliker, K. (2001), 'Bringing Together or Driving Apart the Union? Towards a Theory of Differentiated Integration'.
14. Feira European Council, *Presidency Conclusions*, 19 and 20 June 2000, Annexe IV.
15. Adler-Nissen, R. (2008), 'The Diplomacy of Opting Out: A Bourdieudian Approach to National Integration Strategies', in: *Journal of Common Market Studies*, 46(3): 663–684.

A member state can exert the most influence as a reliable partner that joins the negotiation process from the beginning, especially since, according to Adler-Nissen,[16] non-participants will also be affected by cooperation among the other member states. Take, for instance, the United Kingdom, which already has a stamp levy and so risks double taxation. It would thus be harmful not to have a seat at the table.

The danger of loss of influence on other dossiers has decreased considerably as opting out has become normalised. Yet a presumption remains that member states might face a blow to their image from other member states that do adopt a policy proposal on the basis of the essential European principles of solidarity and equality. First, however, as Adler-Nissen explains, this is mitigated by social practices within the EU, in which member states can shape the process by compensatory measures in other policy areas or strategies. Second, agreements and treaties on economic governance show that member states suffer fewer consequences from opting out, although this is strongly influenced by a country's size. A large member state is better positioned within the negotiations and can alter discussions at an EU level, while small member states might face a larger loss if they are excluded from the integration process.

Furthermore, the enhanced cooperation procedure will have a limited impact on another potential negative consequence of opting out: the so-called 'integration dilemma' – that is, 'an uncomfortable dilemma between being entrapped in the integration system by giving up substantial parts of political authority and being abandoned by the integration system by insisting on preserving formal state-based sovereignty'.[17] An increasing number of member states may decide not to adopt a certain unpopular policy in order to 'safeguard their sovereignty'. In the case of the FTT, the member states that have decided not to partake in this policy will probably not feel 'abandoned', since they form a large group.

Paradoxically, this can lead to a boost in democratic legitimacy in the member states. New measures taken by the EU in light of the financial crisis focus on centralising power towards Brussels, thereby leaving the citizens behind. A perverse trend is emerging, where more powers are conferred to Brussels, but citizens' trust in the EU institutions is decreasing. If opting out occurs more often, there will be increased flexibility in government decisions towards specific policy issues. A national government will therefore have to explain its choice to its citizens, and cannot any longer 'hide' behind Brussels' consensus, thus leading to an increase of democratic legitimacy.

Conclusions and recommendations

- *Experiments and driving forces indicate the actual introduction of the FTT in the coming year(s).* This will probably result in a complex system with many compensatory measures that will also have a large impact on non-participating (member) states.

- *In theory, the FTT operates best if applied on a global scale. It would therefore be advisable to involve non-EU members in the deliberations, in order to create: 1) a broader base of partakers; and 2) more ownership in these countries with a view to the FTT's possible introduction there in the longer term.* Furthermore, there is the need for an assessment of the preferred institutional architecture per policy area, considering among others voting rights in the Council and the European Parliament.

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16. Adler-Nissen, R. (2011), 'Opting Out of an Ever Closer Union: The Integration *Doxa* and the Management of Sovereignty', at p. 1094.
17. Adler-Nissen, R. (2008), 'The Diplomacy of Opting Out: A Bourdieudian Approach to National Integration Strategies', at p. 666–667.

- *It seems that the use of differentiated integration, and especially variable geometry, is expanding in the EU, especially for complex issues that initially seem unattractive in the eyes of many member states.* The case of the FTT illustrates that it is even used for a disguised form of tax harmonisation. From this perspective, EU unity in the long run is all but certain, and seems to move towards functional, sector-specific regimes.

- *Concerning the politics of opt-outs, although appearing opportunistic, in most cases it remains better to be seated at the table, even when a particular dossier is initially unattractive.* If a country does not participate, it is largely excluded from decision-making while it remains affected by the policy. Participating in the development phase might lead to compensations instead of accepting a *fait accompli* in the future.

- *As a consequence of functional, sector-specific regimes, a member state's image as an outcast if it does not participate will probably fade.* This calls for a different and constructive approach towards policy instruments such as enhanced cooperation, based on a country's size.

- *Finally, opting out of certain policies might create more democratic legitimacy if it leads to politicised debates at the national level.*

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