MOCK STUDY ON "FINANCIAL ACTIVITY TAX"

1. BACKGROUND

In the aftermath of the financial crisis, an increasing international debate has started among academics and among policy makers on the taxation of the financial sector. There was among many a perception that the financial sector bears responsibility in the occurrence and the extent of the crisis. In particular, the financial sector might be too large and take too much risk due to actual or expected state support (resulting in moral hazard), information asymmetries and remuneration structures which together with macroeconomic developments contributed to the recent crisis. In addition, the financial sector has been relatively profitable in the last two decades and there was/is a desire to ensure that the financial sector makes a fair and substantial contribution to public finances. Taken together, these elements have constituted rationales for opening a debate as whether additional or increased taxes on the financial sector could help with consolidation and increased efficiency and stability of financial markets.

The deepness of the crisis, the perception that the financial sector bears responsibilities in its occurrence, the public support received by the sector and - in Europe - the finding that the sector may be under-taxed due to its exemption to VAT led to discussions on possible additional taxes. In response to the request of the G20 leaders to "prepare a report … with regards to the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burden associated with government interventions to repair the banking system," the International Monetary Fund issued a report in September 2010 (http://www.imf.org/external/np/seminars/eng/2010/paris/pdf/090110.pdf). After analysing various options, it proposed two forms of contribution from the financial sector, serving distinct purposes: (1) a Financial Stability Contribution (or Bank Levy) linked to a resolution mechanism and which would be levied at a flat rate on all financial institutions on a base reflecting their inherent riskiness and contribution to systemic risk, and (2) a financial activities tax (FAT) on the sum of profit and remuneration of individual institutions and paid to the general budget. Iceland, Israel, and Quebec would have taxes of the FAT type, and France and Denmark have employ variants which contain some FAT elements.

In the European Union, the European Commission (EC) has adopted in September 2011 a proposal for a Council directive on a common system of financial transaction tax (FTT). The Impact Assessment looked at both the FTT and the FAT (http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/ftt_back ground_en.htm). Given the absence of unanimity among the 27 member states, 11 of them wrote to the EC officially requesting enhanced cooperation on the FTT to be authorized, on the basis of the Commission's 2011 proposal. The EC set out such a proposal in February 2013.

Within its G-20 report which focuses on making the financial sector pay for public interventions, the IMF has proposed introducing a Financial Activities Tax (FAT). A similar proposal was recently made by the French Council of Economic Analysis (http://www.cae-eco.fr/IMG/pdf/cae-note014-en.pdf).

In its simplest form, a FAT is a tax targeted to the financial sector and whose base is the sum of profit and remunerations in the sector. One rationale behind this base is the fact that would a rent occur, it will go either to shareholder in terms of higher profit (dividends or capital gains) or to workers (via higher remuneration). One additional feature of the FAT is that in accounting terms, the sum of profit and remunerations represents the value-added of the sector. With adequate design, a FAT could therefore mimic ex-post the value-added that is difficult to assess on a transaction basis and could then be a proxy for VAT. Besides compensating for VAT exemption and tackling possible rents in the sector, a FAT could also try to address two additional policy objectives. First, because it represents an additional burden on the sector which could translate into prices of financial services, a FAT could decrease the size of the financial sector. Second, a FAT could try to reduce risk-taking by targeting the profit generated by risky activities. This relies however on the assumption that risk is correlated with high return. In that case, taking the return to factors above their 'normal' level would achieve the objective. Finally, a FAT can take several possible forms depending on how profit and remunerations are defined.

The European Commission would be interested in having a report on the economics of the different FAT types, inter alia its effects on incentives, its efficacy to reach its assigned objectives, its revenue potential, its economic effects. Based on this, the tenderer shall carry out the tasks hereunder in the space indicated.

2. TASKS TO BE CARRIED OUT IN THE MOCK STUDY

(a) Task 1: Work plan, timing and resource allocation (3 pages maximum).

For the purpose of this mock study, it is assumed that the final draft report shall be delivered 10 months after the signature of the contract. Precise the research question, draw up a work plan, propose a study team structure and resource allocation plan (use only profiles as listed in the price table annexed to the tendering specifications).

(b) Task 2: Review of the economic literature (3 pages maximum).

Explain your strategy for reviewing the economic literature, the sources that would be consulted and cite/explain already what you consider to be key contributions on the topic and how they contribute to the understanding of FAT.

(c) Task 3: Identification of additional original research to be carried out (3 pages maximum).

From your review of the literature, indicate which area(s) of FAT deserve additional original research. Explain why and how your original research would add to the existing literature.

(d) Task 4: Description of available databases and justification of the choices (5 pages maximum).

For the purpose of task 3, describe the databases that would be consulted (indicating and differentiating which ones you have already access to from those that you would need to acquire). Indicate how they would be used and for what purpose. Justify your choices in comparison to other possible sources.

(e) Task 5: Description and justification of the (empirical) methodology/methodologies and (theoretical and simulation) models chosen (5 pages max).

For the purpose of task 3, describe your research strategy in terms of methodologies to be used and link those to the databases described in task 4.

(f) Task 6: Description of the quality control (2 pages maximum).

Explain which internal and/or external quality control you would apply to ensure the quality of the study.

(g) Task 7 : Describe the cost estimation method(s) and model(s) (3 pages maximum)

Describe the method(s) and model(s) used for estimating cost and effort and illustrate how the use of this method(s)/model(s) lead to the resource allocation plan requested in Task 1 above.