EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 24 July 2012

on the financial transaction tax

(CON/2012/59)

Introduction and legal basis

On 3 July 2012, the European Central Bank (ECB) received a request from the Hungarian Ministry for the National Economy for an opinion on a new draft law introducing a financial transaction tax (hereinafter the 'FTT Law'). On 5 July 2012 the ECB received a request from the Ministry for an opinion on a new amending proposal to the FTT Law. On 9 July 2012 the Parliament adopted the FTT Law with the changes introduced by the new amending proposal.

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third indent of Article 2(1) and Article 2 (2) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the FTT Law relates to the Magyar Nemzeti Bank (MNB) and its monetary policy instruments. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the FTT Law

The FTT will become payable in connection with:

(a) the specified types of payment obligations whereby at the value date of the relevant transfer order the payment service provider with a head office or branch in Hungary is obliged to pay the tax calculated as a percentage of the amount debited on the payer's payment account or of the money transfer. The applicable tax rate is 0.1%, subject to a cap of HUF 6 000 per payment; and

(b) the issuance of MNB bills with a maturity of up to two weeks, or the placement of overnight deposits with the MNB, whereby at the issuance or the value date, the MNB is obliged to pay the tax calculated as a percentage of the face value of the security discounted with the daily central bank base interest or of the amount of the overnight deposit. The applicable tax rate is 0.01% for the overnight deposits and 0.1% for the MNB bills, without a cap.

1 OJ L 189, 3.7.1998, p. 42.

2. Breach of the consultation obligation

The ECB received the initial request by the Ministry for an urgent consultation on the FTT Law on 3 July 2012. A revised version of the law, introducing further changes to the MNB-related provisions, was received by the ECB on 5 July 2012. The Parliament adopted the FTT Law less than two business days later on 9 July 2012.

According to Article 4 of Decision 98/415/EC, the ECB must be consulted 'at an appropriate stage' in the legislative process. This implies that the consultation should take place at a point in the legislative process which affords the ECB sufficient time to examine the draft legislative provisions and adopt its opinion, and also enables the relevant national authorities to take the ECB's opinion into consideration before the provisions are adopted.

In this respect, the ECB once again stresses its position that even cases of particular urgency do not relieve national authorities from their duty to consult the ECB and to allow sufficient time to take into account its views in accordance with Decision 98/415/EC. The Hungarian Government should have postponed the final vote on the draft law until such time that would have allowed for a proper consultation with the ECB, as well as due consideration of the ECB Opinion. Furthermore, the ECB would appreciate the Ministry honouring its obligation to consult the ECB in due time in the future.

3. Effects of the FTT on the MNB

The MNB is a public institution whose primary objective, in line with the Treaty, the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB') and the Law on the MNB, is to maintain price stability[2]. The main task carried out by the MNB for maintaining price stability is to define and implement monetary policy. In performance of such tasks by the MNB, the Hungarian authorities should respect the principle of central bank independence.

The principle of central bank independence referred to in Article 130 of the Treaty and Article 7 of the Statute of the ESCB requires *inter alia* that: (i) an NCB's functional independence is ensured by having the necessary means and instruments for achieving price stability independently of any other authority, (ii) an NCB's institutional independence is respected and the NCB is not influenced by third parties in the performance of its tasks, and (iii) an NCB enjoys financial independence[3].

However, the new FTT Law impairs MNB's functional and institutional independence[4].

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2 Article 127(1), first sentence of the Treaty and Article 2, first sentence of the Statute of the ESCB. Section 2(1) of Law CCVIII of 2011 on the Magyar Nemzeti Bank.

3 The concept of financial independence should be assessed from the perspective of whether any third party is able to exercise direct or indirect influence over the NCB's ability to fulfil its mandate, both operationally in terms of manpower and financially in terms of appropriate financial resources. See ECB Convergence Report May 2012, p. 25. The NCB should in all circumstances have at its disposal the necessary resources to conduct monetary policy. Hence, it is of utmost importance to allow the central bank to make a sufficient provision of reserves during years of profits in order to face possible future losses without weakening its financial means to implement its monetary policy. See also paragraph 2.4.1 of ECB Opinion CON/2009/83.

4 See also Section 1(2) of Law CCVIII of 2011 on the Magyar Nemzeti Bank.

First, it disrupts the monetary policy transmission mechanism[5] by affecting the attractiveness of overnight deposits and MNB bills to the MNB and commercial banks, depending on the final burden-sharing of the tax.

In this respect, while generally a central bank is expected to exercise financial prudence, its measures need to be driven by its monetary policy role and not by profit/cost assessments. Thus, in line with its mandate, the MNB may not simply transfer the burden of the FTT to its counterparties by, for instance, lowering its deposit interest rate. The MNB is not a commercial entity and such decision has to be determined by price stability concerns such as a need to increase liquidity in the market. In addition, the FTT can indirectly affect monetary policy implementation through its likely detrimental impact on financial market liquidity that could impede price discovery. This will complicate the achievement of the MNB's monetary policy objectives.

Second, the FTT affects the ability of the MNB to select freely the monetary policy tools that best serve the primary objective of price stability, as it introduces cost considerations that are unrelated to the original design of such tools. Thus monetary policy instruments best suited for transmitting the MNB policy decisions to the wider economy in the absence of the FTT could be severely disabled by subjecting them to the FTT.

In addition, the imposition of the FTT on the MNB's operations, which is not justified for the reasons specified above, may interfere with the MNB's financial independence. The MNB would need to pay the FTT from its own resources leading to *de facto* limiting the financial resources available to the MNB to carry out its ESCB-related tasks.

The imposition of a tax on the MNB's monetary policy operations, which is not compatible with the MNB's functional and institutional independence and thus not justified for the reasons specified above, could also be seen as creating means to finance the public sector from central bank money. Therefore, the MNB's payment of the FTT to the State is not compatible with the monetary financing prohibition laid down in Article 123(1) of the Treaty[6].

4. The general impact of an unharmonised introduction of the FTT

The ECB has drawn attention to the potential negative side-effects of the Hungarian Government's previous policy of temporarily raising the financial sector's tax burden on the financial sector's capital

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5 Since the summer of 2001, monetary policy in Hungary has been conducted within an inflation-targeting framework, under which the MNB aims to meet a publicly announced inflation target using various monetary policy instruments. The main instrument of monetary policy is the central bank base rate, which affects future inflationary developments via various channels of monetary transmission. Within this framework, the MNB conducts open market operations with two-week MNB bills (debt issuances) that carry the base rate, and accepts deposits by commercial banks at interest rates linked to the base rate, with a corresponding impact on banking sector liquidity and the wider spectrum of interest rates.

6 The prohibition on monetary financing under Article 123 of the Treaty aims at preventing central banks from providing overdraft facilities or any other type of credit facility to the public sector, which includes any financing of the public sector's obligations vis-à-vis third parties. See ECB Convergence Report May 2012, p. 28.

accumulation ability and credit availability[7]. The FTT Law's introduction of a permanent FTT, particularly in a manner which is not harmonised with other Member States, may produce distortions in financial markets and the real economy through: (i) increasing the cost of capital as the tax burden is likely to be shared with users of financial services, (ii) reducing financial market liquidity and access to finance, by increasing the costs of transactions, and (iii) producing incentives for tax evasion and/or avoidance that may, *inter alia*, divert economic and financial activity to other Member States. The ECB draws the attention of the Hungarian authorities to the advanced legislative process for harmonisation of the FTT at Union level through the proposal for a Council directive on a common system of financial transaction tax and amending Directive 2008/7/EC (hereinafter the 'proposed FTT Directive')[8]. While the legislative process is still on-going, the ECB considers that such harmonisation, in particular the exclusion of transactions with the ESCB central banks from the FTT base, is important to avoid a 'negative impact on the refinancing possibilities of financial institutions or on monetary policies in general'[9] and to mitigate economic distortions.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 24 July 2012.

[signed]

The Vice-President of the ECB

Vítor CONSTÂNCIO

7 See paragraph 3.2 of ECB Opinion CON/2010/62. In 2010, a special tax, envisioned as a temporary measure, was imposed on financial institutions. The tax was applied at differentiated tax rates on banks' balance sheet totals at 2009 (constant base).

8 COM(2011) 594 final of 28 September 2011.

9 See Article 1(4)(d) and recital 6 of the proposed FTT Directive.