Currency Transaction Tax and Its Conformity with the Free Movement of Capital and Monetary Policy

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I. Introduction

Taxation of financial transactions and currency exchange has been discussed and debated by economists and politicians ever since John Keynes first called for a taxation of stock market transactions.[1] Keynes argued that too much speculative trade in financial markets could cause macroeconomic damages: „[W]hen the capital development of a country becomes a by-product of the activities of a casino the job is likely to be ill-done."[2] This viewpoint was later endorsed by James Tobin, who suggested a uniform tax on currency exchange when the Bretton-Wood system of fixed exchange rates collapsed in 1971.[3] Tobin argued that volatility in major exchange rates would decrease efficiency of international capital allocation and lead to poor macroeconomic decision making by governments; he colorfully declared that „we need to throw some sand in the well-greased wheels."[4]

Even though the tax has been discussed and researched for decades and taxation of financial transactions has been introduced in several economies,[5] a coordinated international tax remains ethereal. However, the recent financial crisis that started in 2007 with its culmination in 2008-2009 and the vast expansion of currency exchange markets have intensified discussion on introducing regulatory practice to the currency exchange and the idea of a currency transaction tax is once again on the global agenda.

At the center of this discussion lies the European Union (EU). Europe accounts for 55 percent of foreign exchange transactions worldwide due to being home to several important trading centers and containing the world's largest currency market in London.[6] Consequently, by imposing a currency transaction tax, even at a very low rate, large sums of money could be collected to supplement the EU budget,[7] meet UN Millennium Goals,[8] or create a common rescue fund for bailing out economies in financial distress. However, imposing a tax on currency exchange is not possible without taking the supranational legal body of the EU into consideration.

In 2004, the European Central Bank (ECB) raised concerns regarding the tax, arguing that it might intrude on the European System of Central Banks' (ESCB) exclusive competence in matters of monetary policy.[9] Another concern involved issues related to the free movement of capital.[10] To date, the ECB is the only EU institution to issue an assessment of the proposed tax. In a 2010 report from the European Commission discussing taxation of the financial sector, it was concluded that the legal aspects of a transaction tax are unresolved: „legal obstacles need to be taken into account, regarding its compatibility with free movement of capital and payments between Member States."[11]

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1 *J. M. Keynes*, The general theory of employment, interest and money, 1936, p. 147 ff.

2 *J. M. Keynes* (supra note 1), p. 159.

3 *J. Tobin*, Eastern Economic Journal, 1978, 153 ff.

4 *J. Tobin* (supra note 3), p. 158.

5 International Monetary Fund, A fair and substantial contribution by the financial sector, 2010, p. 60 ff.

6 Bank of International Settlements, Triennial central bank survey: Report on global foreign exchange market activity in 2010, 2010, p. 18.

7 *S. Richter*, Seeking new ways of financing the EU budget, wiiw research report no. 345, 2008.

8 *J. D. Sachs*, A practical plan to achieve the millennium development goals, 2005, p. 256.

9 *ECB*, CON/2004/34, 2004, p. 4.

10 *ECB* (supra note 9).

11 *European Commission*, SEC(2010) 1166/3, 2010, p. 19.

This leaves the EU in a situation where the European Parliament consistently votes in favor of an EU-wide transaction tax,[12] but questions regarding its conformity with current EU treaties are yet to be resolved.[13]

This article takes an initial look at the legal aspects of implementing a currency transaction tax, namely: Is implementation of a currency transaction tax compatible with the free movement of capital and the ESCB's exclusive right to set monetary policy in the Euro zone?

II. Currency transaction tax in Europe

1. The call for a EU-wide currency transaction tax

In April 2011, 1,000 economists from 53 countries signed a letter addressed to the G20 finance ministers urging implementation of a worldwide currency transaction tax and asking French president Nicolas Sarkozy, current chair of the G20, to make the tax his key priority.[14] At a less global level, the European Parliament adopted a resolution in 2010 stating that the „EU, in parallel to and in consistent with the G20 work, should develop its own strategy."[15]

In a March 2011 resolution on innovative finance at the global and European level, the European Parliament continued to stress this issue and decided to begin work on implementing a feasible type of transaction tax: „the introduction of a transaction tax could help to tackle the highly damaging trading patterns in financial markets, such as some short-term and automated high-frequency trading transactions, and curb speculation."[16]

2. Proposed structure of the currency transaction tax

There are several technical models that could be used to design a currency transaction tax but, as yet, no agreement on which one would be most appropriate for the EU.[17] However, in 2002, Patomäki and Denys outlined a draft treaty (CTT Treaty).[18] The draft treaty was designed to meet the need for a common technical platform and harmonized definitions of many of the legally important aspects of the currency transaction tax.[19] The Value Added Tax (VAT) Directive 77/388/EEC[20] was an inspiration in creating the treaty due to its success in harmonizing the VAT in the EU.[21] Its similarities to the Sixth VAT Directive[22] and its inclusion of definitions for important technical details made the CTT Treaty a frequently referred-to document in discussions about introducing a Europe-wide currency transaction tax. Indeed, the CTT Treaty has been referred to and used in national proposals to several Member States; examples are Motion 2005/06:Fi227[23] to the Swedish Parliament in 2005 and the Belgian currency transaction tax legislation in 2004. The CTT Treaty's detailed technical system for implementing the currency transaction tax, which takes into consideration legal aspects, has gone a long way toward making the theoretical concept of the currency transaction tax a reality.

We thus use the CTT Treaty to define the structure of the currency transaction tax, which we consider to be appropriate, even though the CTT Treaty is still just a concept. Our rationale for doing so is bolstered by the fact that one very real currency transaction tax (in Belgium) was based on the CTT Treaty.[24]

The currency transaction tax described in the CTT Treaty is based on suggestions made by *Spahn* in 1996 in regard to a two-tier currency transaction tax (referred to as the Spahn tax) and therefore consists of two tax rates. The first tax rate is a low-tariff tax of 0.1 percent imposed on all currency spot and forward transactions and foreign exchange derivatives. This rate is mainly designed to raise capital and is regarded as too small to prevent high volatility on the currency market.[25] The second tax rate is a high-tariff tax of 80 percent, the sole purpose of which is to almost completely stop currency trading. This tax is triggered only when the exchange rate moves outside a band determined by a crawling peg plus a safety margin.[26] This should occur only during extreme periods of currency speculation attacks.[27]

Based on this structure of the currency transaction tax, this contribution discusses whether the tax is in conformity with the free movement of capital. Whether this particular structure is the most feasible for the European market is not discussed, but the same reasoning applied to determine its conformity with the free movement of capital should apply in general to all forms of transaction tax.

III. Conformity between a currency transaction tax and the free movement of capital

1. Restriction-based analysis model

To fathom whether the currency transaction tax poses an obstacle to the free movement of capital, a series of steps needs to be analyzed. Figure 1 illustrates the procedure for identifying potential obstacles based on the provisions in Articles 63 – 65 of Treaty Forming the European Union (TFEU), which regulates the free movement of capital. This is the restriction-based model most frequently used by the Court of Justice of the European Union (ECJ) in cases involving the free

12 *European Parliament*, Resolution B7-0133/2010 on financial transaction taxes-making them work, 2010.
13 *European Parliament*, Resolution A7-0036/2011 on innovative financing at global and European level, 2011.
14 *H. Stewart*, The Guardian, 13 April 2011.
15 European Parliament (supra note 12).
16 European Parliament (supra note 13).
17 European Parliament (supra note 13).
18 *H. Patomäki/L. A. Denys*, Draft treaty on global currency transaction tax, 2002.
19 *H. Patomäki/L. A. Denys* (supra note 18).
20 *Council of the European Union*, Directive 77/388/EEC, 1977.
21 *H. Patomäki./L. A. Denys* (supra note 18).
22 Council of the European Union (supra note 20).
23 *Swedish Parliament*, Motion 2005/06:Fi227 Tobin, valutahandel och globala skatter, 2005.
24 *ECB* (supra note 9).
25 *P. B. Spahn*, Finance & Development, 1996, 24 (26).
26 *P. B. Spahn* (supra note 25).
27 *P. B. Spahn* (supra note 25).

movement of capital.[28] Following these steps is the most reliable way of assessing whether the currency transaction tax is in conformity with the free movement of capital since the ECJ endorsement of the *Säger* formula,[29] which amended the provision to not only prohibit discrimination, but also restrictions.[30]

Restriction-based analysis model of a currency transaction tax

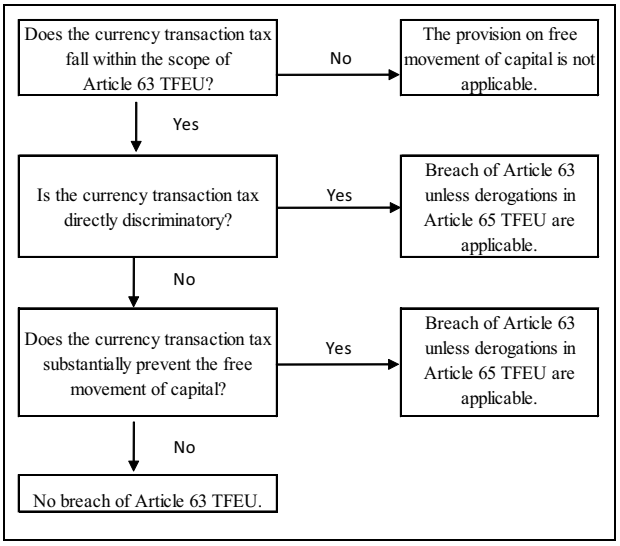

Figure 1: Procedure for identifying potential obstacles based on the provisions in Akticles 63–65 TFEU

Based on the restriction-based model, the following steps are required to assess conformity with the free movement of capital.[31] The first step, before analyzing the specific articles, is to determine if the currency transaction tax even falls within the Article 63 provision's scope.[32] To ascertain whether the provision is applicable, it is necessary to identify the type of transactions the currency transaction tax levies taxes on and whether they are covered under the legal definition of the movement of capital.[33] If the foreign exchange the currency transaction tax targets does fit within the definition of a movement of capital, the second step is to identify whether the currency transaction tax does in fact constitute a form of direct discrimination.[34] If the currency transaction tax is found to be directly discriminatory, the express derogations in Article 65 TFEU are perused to find out whether the discrimination is justified.[35] In the third step, in the event the currency transaction tax is found to be non-discriminatory or indirectly discriminatory, it is necessary to analyze whether the measure substantially prevents the free movement of capital. If it is a substantial hindrance, the same express derogations in Article 65 TFEU are examined again, as the possibility of justifying the measure based on the general interest.[36]

These steps are assessed separately in figure 1, organized after the restriction-based model, to discover whether the currency transaction tax discriminates against or restricts the free movement of capital.

2. Does the currency transaction tax fall within the scope of Article 63 TFEU?

Article 63(1) TFEU stipulates that „all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."[37] To determine whether the provision is applicable to the currency transaction tax, it is necessary to define what constitutes a movement of capital, as well as define the territorial scope of the provision.

Article 63 TFEU substantially reproduces Article 1 of Directive 88/361,[38] which contains a nomenclature of transactions defined as capital movement. The ECJ has ruled that this nomenclature should have indicative value for the definition of capital in provisions of the TFEU.[39] Directive 88/361[40] contains an extensive list of transactions and payments regarded as movement of capital. The list is divided into four main areas, namely, direct investments, establishment, provision of financial services, and admission of securities to capital markets.[41]

Foreign exchange transactions are not mentioned in the nomenclature. Furthermore, in case *Sanz de Lera*,[42] the ECJ ruled that the action of a person trying to cross a border between member states in a car filled with money is not a movement of capital and thus the provision was inapplicable.[43] This ruling could be interpreted to mean that the currency transaction tax, also, falls outside the provision since it is levied on currency exchange transactions. However, the fact that foreign exchange is not included in Directive 88/361[44] does not per se mean that it is not a form of capital movement in the legal sense of the term. In several cases, the ECJ has expanded the scope of the freedom provision to include transactions closely connected to items on the Directive's list.[45] Further analysis is required to determine if currency exchange can possibly be interpreted as a capital movement under Directive 88/361.[46]

28 *C. Barnard*, The substantive law of the EU[3], 2010, p. 572.
29 European Court of Justice, C-76/90 [1991] ECR I-4221, 1991.
30 European Court of Justice, C-165/98 Mazzoleni [2001] ECR I- 2189, 2001.
31 *C. Barnard* (supra note 28), p. 573.
32 Art. 63 TFEU.
33 Art. 63 TFEU.
34 Art. 63 TFEU.
35 Art. 65 TFEU.
36 Art. 65 TFEU.
37 Art. 63(1) TFEU.
38 Council of the European Union, Directive 88/361/EEC [1988] OJ L178/5, 1988.
39 European Court of Justice, Case C-222/97 ECR I-1661, 1999, para. 21.
40 Council of the European Union (supra note 38).
41 Council of the European Union (supra note 38).
42 European Court of Justice, Joined Cases C-163/94, C-165/94, and C-250/94 ECR I-4830, 1995, para. 33.
43 European Court of Justice (supra note 42).
44 Council of the European Union (supra note 38).
45 European Court of Justice, Case C-35/98 ECR I-4071, 2000, paras. 28–29.
46 Council of the European Union (supra note 38).

The currency transaction tax levies taxes on all direct and indirect currency transactions, including transactions on the spot and forward markets. This feature makes the currency transaction tax very closely related to other financial instruments listed in Directive 88/361.[47] Listed transactions that are similar to currency exchange include those involving securities and other instruments normally dealt with on the money market, such as treasury bills, certificates of deposit, and foreign money market securities and instruments.[48] Furthermore, the ECJ has ruled that all movements concerning currency transactions and similar financial transactions generally make the free movement of capital provision applicable over the other fundamental freedoms.[49] This ruling, combined with the presence of similar transactions on the list in Directive 88/361, makes it highly likely that currency transactions relevant for the currency transaction tax are movements of capital.

There is also a territorial scope aspect to the free movement of capital. Article 63 TFEU specifies that to qualify for protection, the movement of capital must be between member states or between a member state and a third country. This means that transactions and movement of capital that occur completely within one member state are not covered by the provision. The currency transaction tax makes taxable all transactions defined as cross-border transactions. Payments for goods or exchange of the same currency that occur within a member state are not taxed by the currency transaction tax. Thus, the transactions taxed by the currency transaction tax clearly fit the definition of cross-border transactions between member states or between a member state and a third country. Consequently, the currency transaction tax is within the territorial scope of the provision, which means that the tax falls within the scope of the provision stated in Article 63 TFEU.

3. Is the currency transaction tax directly discriminatory?

The provision on the free movement of capital treats different forms of discrimination distinctly. If a measure is regarded as directly discriminatory, only the express derogations in Article 65 TFEU might justify the measure. If the measure is indirectly discriminatory or not discriminatory, the measure might be justified either by the express derogations in Article 65 TFEU or by proving that the measure is in the public's interest.[50] The public interest justification is similar to the express derogation in Article 65(1)(b) TFEU stipulating that both direct and indirect discrimination may be justified on grounds of public policy and public security.

The determination of whether a measure is directly discriminatory derives from a previous version of the provision in Article 67 EEC. There were three grounds for finding discrimination in that provision: Nationality, the place of residence of the parties and the place the capital is invested.[51] To be found directly discriminatory, the currency transaction tax must differentiate taxation on any one of these three grounds.[52]

All international currency exchange transactions within the territory of the country performed by a taxable person are subject to currency transaction tax.[53] All persons who engage in a taxable transaction are taxable persons regardless of their nationality; where the transaction takes place has no bearing.[54] This makes currency transaction tax neutral in terms of the market participant's residence or establishment. However, issues regarding discrimination based on where capital is invested were raised in the ECB report on the Belgian currency transaction tax legislation.[55] The ECB argued that the currency transaction tax „will imply less favourable treatment of certain transactions in the currency of a non-euro area Member State or a third country compared to the same kind of transaction in euro only."[56] Such would be a clear case of direct discrimination.

However, in its statement, the ECB did not interpret the mechanics of the proposed currency transaction tax correctly. The tax is not levied on the use of currency to pay for goods, services, or capital, but only on the exchange of one currency for another.[57] The exchange of currencies may be, but is not necessarily, related to the transfer of goods, services, or capital. Under the currency transaction tax, an investor from one member state can invest in goods, services, and capital from another member state without paying any currency transaction tax. The foreign investor probably will need to exchange currencies at some point in the investment process, of course, which potentially could result in indirect discrimination or a restriction of the free movement of capital. In *Hollman*,[58] the ECJ found a capital gains tax that in fact was higher for non-residents to be a form of indirect discrimination.[59] This ruling suggests that even if a tax is obviously discriminatory in practice, it might be regarded as indirect discrimination instead of direct discrimination. To be defined as directly discriminatory, the measure should be an obvious difference in treatment.[60]

The currency transaction tax does not discriminate on the basis of nationality or place of residence since all taxable transactions are conducted by professional intermediates and taxed without consideration of the nationality or place of residence of the customers.[61] There might be an indirect difference in treatment be-

47 Council of the European Union (supra note 38).
48 Council of the European Union (supra note 38).
49 European Court of Justice, Joined Case C-358/93 and C-416/93 ECR I-361, 1955.
50 Art. 64 TFEU.
51 *C. Barnard* (supra note 28), p. 569.
52 *C. Barnard* (supra note 28), p. 570.
53 *H. Patomäki/L. A. Denys* (supra note 18), art. 5.
54 *H. Patomäki/L. A. Denys* (supra note 18), art. 7 para. 1.
55 ECB (supra note 9), para. 14.
56 ECB (supra note 9), para. 14.
57 *H. Patomäki/L. A. Denys* (supra note 18).
58 European Court of Justice, Case C-443/06 ECR I-8491, 2007.
59 European Court of Justice (supra note 58), para. 36.
60 *N. Foster*, Foster on EU law, 2006, p. 261.
61 *H. Patomäki/L. A. Denys* (supra note 18), art. 13.

tween nationals and non-nationals investing money in a member state, but the difference would be due to the necessity of foreign exchange, not based on the investment itself. Since the currency transaction tax makes foreign exchange more expensive and foreign exchange is necessary to invest in a country that uses a different currency, the currency transaction tax may be seen as indirectly discriminatory. However, the link between the currency transaction tax and transactions involving goods or services is not strong enough to constitute a case of direct discrimination regarding the free movement of capital. There is always a foreign exchange risk to investing in another country, but such a risk is in no way directly discriminatory; if it was, simply the existence of different currencies within the EU would constitute a restriction on the free movement of capital. To conclude, the currency transaction tax may be indirectly discriminatory or constitute a restriction on the free movement of capital due to taxing foreign exchange, but it is not directly discriminatory.

4. Does the currency transaction tax substantially prevent the free movement of capital?

In a series of cases during 2003, the ECJ ruled that non-discriminatory measures that hinder access to the market are a breach of Article 63 TFEU unless they can be objectively justified by reasons of general interest or, in other words, by the „rule of reason."[62]

In 2004, the ECB expressed concern over the Belgian currency transaction tax legislation, stating that the currency transaction tax most probably was a measure that would hinder the execution of capital transfers involving foreign exchange.[63] The same conclusion was reached by EU Commissioner *Frederik Bolkestein*, who was responsible for the internal market and taxation and customs services. However, *Bolkestein* did suggest that the currency transaction tax might be justified under the rule of reason.

The purpose behind the currency transaction tax is to curb speculation, which is a large part of the transactions conducted on the foreign exchange market. This aim makes it clear that the tax is in fact an obstacle to the free movement of capital. The tax also indirectly makes it more difficult to invest capital in another member state since under its provisions the exchange of currency comes at a price. Though, it is not clear whether the currency transaction tax does in fact substantially restrict access to the market. To assess whether it does restrict the free movement of capital, it is preferable to look at the high (80 percent) tax and the low (0.1 percent) tax separately.

The high-tariff currency transaction tax is without doubt a substantial restriction on the free movement of capital on the foreign exchange market. When the exchange rate is outside the fluctuation band, the currency transaction tax is designed to almost completely stop foreign currency exchange,[64] which, of course, if successful would clearly restrict the movement of capital.

The low-tariff currency transaction tax is not so clearly a substantial restriction. The tariff is screamingly low, only 0.1 percent, thus presenting a very small obstacle, and the intention is not to disturb the currency market.[65] However, several reports analyzing the impact of the currency transaction tax conclude that even a low tariff would decrease the volume of trade, thus showing that the currency transaction tax would constitute an effective obstacle to the free movement of capital.[66] In *Sandoz*,[67] a recent case involving national taxation and the free movement of capital, the ECJ ruled that mere imposition of a tax was sufficient to constitute a restriction that needs to be justified.[68] Thus, even if the low-tariff currency transaction tax itself is extremely small, it will have a large impact and is therefore an obstruction to the free movement of capital.

It is thus clear that both the low- and high-tariff currency transaction tax substantially restrict the free movement of capital. Therefore, the currency transaction tax must be further analyzed to determine whether the express derogations in Article 65 TFEU or the rule of reason can justify the restriction it imposes.

5. Are any of the express derogations in Article 65(1) TFEU applicable?

Article 65(1) TFEU stipulates two tax-related derogations, one general and one specific. The ECJ has ruled that both are to be interpreted strictly.[69] The first derogation, found in Article 65(1)(a) TFEU, is specific to tax and sets out acceptable tax provisions distinguishing between residents and non-resident taxpayers or having to do with the place capital is invested.[70] However, this derogation is applicable only to tax provisions in existence at the end of 1993 and to transactions between member states.[71] Since the currency transaction tax is a new, not yet implemented, tax that will be levied on transactions between member states, more precisely between member states with different currencies, the derogation in Article 65(1)(a) TFEU is not applicable to the currency transaction tax.

The second set of derogations is found in Article 65(1)(b) TFEU and consists of three possible general derogations to the free movement of capital. The first derogation stipulates that measures to protect national law are acceptable, more precisely, „all requisite measures to prevent infringements of national law

62 European Court of Justice, Case C-463/00 ECR I-4581 and Case C-98/01 ECR I-4641, 2003.
63 ECB (supra note 9), p. 19.
64 *P. B. Spahn* (supra note 25).
65 *P. B. Spahn* (supra note 25).
66 *H. Patomäki*, Democratising globalisation: The leverage of the Tobin tax, 2001.
67 European Court of Justice, Case C-439/97 ECR I-7041, 1999.
68 European Court of Justice (supra note 67), para. 30.
69 European Court of Justice, Case C-54/99 ECR I-1335, 2000, para. 17.
70 Art. 65(1)(a) TFEU.
71 Declaration no. 7 on Article 73 d of the Treaty establishing the European Community annexed to the Final Act of the EC.

and regulations, in particular in the field of taxation and the prudential provision of financial institutions."[72] This derogation is intended to allow measures necessary to prevent illegal tax evasion. The currency transaction tax is not of this character.

The second derogation in Article 65(1)(b) TFEU allows measures to „lay down procedures for the declaration of capital movements for purposes of administrative or statistical information."[73] As the currency transaction tax is not intended to collect or provide information of this nature, this derogation is not applicable to it.

The third and last derogation in Article 65(1)(b) TFEU states that each member state may take „measures which are justified on grounds of public policy or public security." This is similar to the rule of reason, but with an important difference: the derogation allows measures that are intended to *protect* the public, whereas the rule of reason is less specific and allows all measures that *benefit* the public, as long as they are in proportion. Thus the derogation in Article 65(1)(b) TFEU is more strict than the rule of reason, and to make it applicable, the ECJ has determined that it is necessary to identify and prove „a genuine and sufficiently serious threat to a fundamental interest of society."[74] The currency transaction tax aims to curb speculation and to safeguard the domestic currency from fluctuations created by speculation, a goal well within the interests of public security. However, the ECJ is cautious about allowing member states to use this derogation. For example, in *Albore*,[75] the ECJ stated that a mere reference to public policy or security is not in itself sufficient to justify restrictive measures;[76] instead, it must be demonstrated that in the absence of the restriction, the member state will be exposed to real, specific, and serious risk that cannot be countered by other, less restrictive measures.[77]

There is ongoing debate as to whether liberal capital flows actually do create currency fluctuations and, if so, whether the currency transaction tax would in fact decrease the speculation that can potentially create such fluctuation.[78] That there is even such a debate about the effectiveness of the currency transaction tax to stop currency crises makes it obvious that the currency transaction tax is far from a clearly necessary measure to protect against a clear and definable threat to society. The necessary threat to national security is not clearly defined in the derogation, and the consequences of not applying a currency transaction tax are impossible to know at this point. Both uncertainties make it clear that the derogation in Article 65(1)(b) TFEU does not apply to the currency transaction tax.

To conclude, none of the express derogations in Article 65(1) TFEU are applicable to the currency transaction tax. Both the low- and high-tariff currency transaction tax fail to be justified by public policy or public safety concerns due to the lack of certainty that such a measure is the less restrictive means of solving a problem that some economists claim is non-existent. Thus, currency transaction tax must be further analyzed under the rule of reason.

6. Is the rule of reason applicable?

The rule of reason doctrine, first set out in *Gebhard*,[79] was found by the ECJ in *Commission v. Portugal*[80] to be applicable to the free movement of capital. The rule of reason stipulates that a measure is acceptable if five criteria are met. That is, the measure is acceptable if:[81]

It is justified by reasons of public interest;

is suitable for the realization of the objective;

goes no further than necessary to realize the objective;

is applied without discrimination; and

is compatible with specific EU law.

The rule of reason has been applied to a great variety of measures and is less specific than the derogation in Article 65(1)(b) TFEU, which allows justification only in the case of public policy or public security.[82]

Among the currency transaction tax's objectives are the stabilization of capital markets and the raising of capital to be used for the common good, both of which are in the public interest. The currency transaction tax is also a suitable instrument for realizing these objectives. There is, as mentioned, debate as to whether there is even a need to curb speculation and, if so, the currency transaction tax is the least restrictive means of doing so. But the general consensus derived from economic research on the currency transaction tax is that the currency transaction tax would curb speculation and consequently decrease fluctuation. The capital raised from the currency transaction tax would also serve the public interest by being used to support the UN Millennium Development Goals and similar projects.[83] The currency transaction tax is thus clearly in the public's interest.

To determine whether the currency transaction tax is a suitable means of achieving the stated objectives, it is appropriate to analyze the high- and low-tariff currency transaction taxes separately. The low-tariff currency transaction tax is certainly low, only 0.1 percent, and there are no less obstructive options with similar budgetary effect.[84] The low-tariff currency transaction tax does not go further than necessary to realize the currency transaction tax's objectives. The high-tariff currency transaction tax, however, is an ex-

72 Art. 65(1)(b) TFEU.
73 Art. 65(1)(b) TFEU.
74 European Court of Justice (supra note 69), para. 18.
75 European Court of Justice, Case C-423/98 ECR I-5965, 2000.
76 European Court of Justice (supra note 75), para. 21.
77 European Court of Justice (supra note 75), para. 22.
78 *S. Umlauf*, Journal of Financial Economics, 1993, 277.
79 European Court of Justice, Case C-55/94 ECR I-4165, 1995.
80 European Court of Justice, Case C-367/98 ECR I-4731, 2002.
81 European Court of Justice (supra note 79).
82 Art. 65(1)(b) TFEU.
83 *H. Patomäki* (supra note 66), p. 175.
84 *H. Patomäki/L. A. Denys* (supra note 18), p. 226.

treme intervention in the free movement of capital that goes well beyond what is necessary to realize the objectives.

Based on the analysis above (see Section 5), it can be stated that the currency transaction tax is levied without direct discrimination, thus meeting the fourth criteria for application of the rule of reason. The last criteria, however, which involves being compatible with existing EU legislation, may pose a problem for the high-tariff currency transaction tax (but not for the low-tariff currency transaction tax). The high-tariff currency transaction tax could be viewed as a monetary policy, which, if so, overlaps with the ESCB's exclusive power over monetary policy in the Euro Zone.[85]

To conclude, the currency transaction tax can be justified under the rule of reason, but just the low-tariff variant of it. The high-tariff currency transaction tax, which is levied only under extreme circumstances, is unproportional and may intrude on the ECB's exclusive power in matters of monetary policy.

IV. Conformity between a currency transaction tax and the EMU

1. Monetary policy

According to Article 127(2) TFEU, the ESCB has exclusive competence in the area of monetary policy for all member states whose currency is the euro.[86] All monetary policy decisions are made by the ESCB, which is composed of all the national central banks and governed by the ECB.[87] All member states with currencies other than the euro retain their power in monetary matters.[88] Article 127 TFEU stipulates that countries both within and outside the Euro Zone must consult the ECB in all legal acts concerning monetary policy.[89] Since the ECSB has exclusive competence regarding monetary policy, only the EU may legislate on such policy and member states in the Euro Zone may act only if so empowered or to implement legislation from the EU.

The low-tariff currency transaction tax levied on all transactions between the fluctuation bands might escape being deemed a measure of monetary policy. A comparison can be made with national VAT legislations, harmonized by the Sixth EU VAT Directive, which concern currency exchange transactions. The VAT on foreign exchange transactions is not seen as a monetary policy and does not violate the EU Treaty.[90] The ECJ has ruled that „foreign exchange transactions are thus supplies of services within the meaning of art. 6 of the Sixth Directive".[91] This ruling means that taxes a country levies on services performed to exchange foreign currency are not regarded as a measure of monetary policy. Both the VAT and the currency transaction tax are indirect taxes. Under an analogous interpretation, it should be completely possible for a member state to implement a low-tariff currency transaction tax without breaching the ESCB's exclusive monetary policy competence. How high the low-tariff currency transaction tax could be set before qualifying as a monetary policy is debatable, but compared to VAT taxes, the currency transaction tax tariff of 0.1 percent is utterly low.

On the other hand, the high-tariff currency transaction tax, which might be as high as 80 percent, is clearly a monetary policy with a definite purpose of controlling capital flows and decreasing trade and speculation in a currency during periods of high volatility.[92] However, the suggested mechanism for this surcharge is designed so that the tax will be levied only with the consent of the EU authorities.[93] The decision to use the higher tariff will always be made by the EU, and then only in the case that national legislation allows for its imposition. The exclusive competence for monetary policy will thus remain intact and the national currency transaction tax law will merely be a necessary prerequisite to a monetary policy decision by the EU.

Nonetheless, when setting monetary policy, the ESCB cannot abrogate the requirement as to free movement of capital. That is, even though the ESCB has exclusive competence on monetary policy, it does not have the right to breach Article 63 TFEU's stipulation of free movement of capital without restrictions. In the analysis of whether the currency transaction tax conforms with the free movement of capital provision, it was concluded that the high-tariff currency transaction tax is an unproportional measure, and is thus prohibited. However, Article 66 TFEU provides some exceptions to the free movement provision that are available under exceptional circumstances and only on the initiative of the EU and these could justify the high-tariff currency transaction tax.

2. Article 66 TFEU and measures during exceptional circumstances

Article 66 TFEU allows the European Council to restrict capital flows to a third country for up to six months under exceptional circumstances. Specifically, Article 66 TFEU states that „in exceptional circumstances, free movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of the economic and monetary union the Council, on a proposal from the Commission and after consulting the European Central Bank, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary".[94]

The high-tariff currency transaction tax is levied only when the currency exchange rate is outside the fluc-

85 Art. 127 TFEU.
86 Art. 127(2) TFEU.
87 Art. 129 TFEU.
88 Art. 283 TFEU.
89 Art. 127 TFEU.
90 European Court of Justice, Case C-172/96 ECR I-4387, 1998.
91 European Court of Justice (supra note 90).
92 *P. B. Spahn* (supra note 25).
93 *H. Patomäki/L. A. Denys* (supra note 18), Art 12.
94 Art. 66 TFEU.

tuation band.[95] This will occur only in exceptional circumstances that are seriously threatening the monetary stability of the Euro Zone. For example, sudden fluctuations in exchange rates might trigger a currency panic, which might lead to a widespread currency crisis. Therefore, if the exchange rate is outside the band and the European Council, after consultation with the ECB, regards it as necessary to activate the high-tariff currency transaction tax, it may do so under Article 66 TFEU for a maximum of six months. Thus the high-tariff currency transaction tax could be effectively employed against excessive currency fluctuation and to create a more stable currency market in the EU. This is in line with the European Monetary Union's (EMU) objective of maintaining price stability.[96]

However, Article 66 TFEU allows the limited breach of the free movement of capital only in respect to third countries. Members of the EMU are considered to be a single state in terms of the currency transaction tax,[97] thus transactions in the same currency between member states in the Euro Zone are not subject to the currency transaction tax.[98] Today, 16 of the 27 member states of the EU are part of the Euro Zone. Transactions between these Euro Zone countries will be exempt from the currency transaction tax since no currency exchange occurs. But between a member state in the Euro Zone and a member state outside the Euro Zone, the high-tariff currency transaction tax will be prohibited.

Even though a member state is not part of the EMU, it still could be influenced by the ESCB's monetary policy. For member states not yet part of the Euro Zone there is a second-generation European Exchange Rate Mechanism (ERM II) designed to link the member state's currency to the euro.[99] The ERM II pegs the domestic currency to the euro, allowing it to fluctuate a maximum of 15 percent.[100] This makes it impossible for exchange rates to violate the fluctuation bands set for the currency transaction tax.[101] Today, only four countries are part of the ERM II (Latvia, Denmark, Lithuania, and Estonia), but all countries that joined the EU during its enlargement in 2004 and 2007 are supposed to eventually join the Euro Zone and all have requested to join the ERM II as a first step.[102] These countries are Bulgaria, Poland, the Czech Republic, Hungary, and Romania.[103] The United Kingdom and Sweden are the only countries with no involvement in European monetary cooperation, meaning that in the near future, the British pound sterling (GBP) and the Swedish krona (SEK) will be the only EU currencies to float freely against the euro (EUR), thus not directly influenced by the monetary policy decisions of the ESCB. This leaves Sweden and United Kingdom as the only two member states that cannot levy the high-tariff currency transaction tax on exchange rates, thus making it possible for the EU to impose the high-tariff currency transaction tax on all existing currency exchange rates except EUR/GBP, EUR/SEK, and GBP/SEK.

V. Conclusion and summary

This article takes an initial look at the legal aspects of implementing a currency transaction tax in the EU, with the specific purpose of analyzing whether implementing a currency transaction tax is compatible with the free movement of capital and the ESCB's exclusive authority over monetary policy in the Euro Zone. This study makes an important contribution to the ongoing discussion of this topic, which is of high interest to both the G20 and the European Parliament.

The currency transaction tax is in conformity with the free movement of capital provision since any restriction it might cause can be justified under the rule of reason. There is one possible exception: the high-tariff currency transaction tax levied during extreme currency rate fluctuations. If the high-tariff currency transaction tax intrudes on the ECSB's exclusive power over monetary policy, it is not justified under the rule of reason. A currency transaction tax without the high-tariff component, howsoever, will not effectively meet the objective of curbing currency rate volatility.

But the ECSB's exclusive competence in monetary policy is argued to remain intact since a national currency transaction tax will be merely a prerequisite for monetary policy decisions by the EU. Nevertheless, the high-tariff currency transaction tax is a prohibited unproportional restriction, and thus it cannot be imposed without the approval of the European Council. Admittedly, under exceptional circumstances, the Council is granted the power to restrict capital flows to a third country for up to six months, providing a legal basis for a temporary restriction on the free movement of capital. Used in this manner, the high-tariff currency transaction tax could be an effective and legal means of controlling currency transactions under extreme circumstances with the goal of maintaining price stability in the EU.

In summary, the currency transaction tax is in conformity with EU treaties. However, it will require the full cooperation of the ESCB and ECB for the high-tariff currency transaction tax to function as intended and achieve its objective of a more stable currency market. The currency transaction tax is an idea whose time has come.

95 *P. B. Spahn* (supra note 25).
96 Art. 127(1) TFEU.
97 *H. Patomäki/L. A. Denys* (supra note 18), art. 8.
98 *H. Patomäki/L. A. Denys* (supra note 18), art. 8, para. 1.
99 *D. Chalmers et al.*, European Union law: Cases and materials[2], 2010, p. 736.
100 *D. Chalmers et al.* (supra note 99), p. 736.
101 *D. Chalmers et al.* (supra note 99), p. 736.
102 *D. Chalmers et al.* (supra note 99), p. 736.
103 *D. Chalmers et al.* (supra note 99), p. 736.