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Bank tax in Hungary

Quick analysis on a debated pioneering step

The idea is not popular Down Under

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Hungary's economy started to recover from its worst recession in 19 years in the last quarter of 2009. Output was hurt by a decline in export orders from the Euro region which buys 60% of Hungary's products and a slump in domestic demand, snapped by five consecutive years of fiscal authority.

Breaking news

Hungarian lawmakers approved a bank tax three times larger than levies proposed elsewhere in Europe[1], defying criticism from international institutions. Newly re-elected after two terms of Socialist Governments, central right Prime Minister Viktor Orbán anchored his plan to meet this year's budget deficit target on the tax, drawing the ire of the European Banking Federation and lenders such as UniCredit SpA of Milan and Erste Group Bank AG of Vienna, which own local banks. Hungary's parliament, where Orbán's party has a two-thirds majority, passed the bill by a vote of 301 to 12 with one abstention on July 22, 2010. The vote came five days after the International Monetary Fund and European Union suspended their review of Hungary's 20 billion-euro (US$25.8 billion) emergency bailout without backing the

[1] The bank tax was part of a package in Parliament called „Proposal on making and modifying certain economic and financial laws" (T581/190).

government's budget plans. The IMF said a number of issues remained unresolved, including the bank tax, which would adversely affect lending and growth. European Union similarly expressed concern to the Government's proposed tax, warning that it could serve to weaken the banks and to damage both the investment climate and the economic growth.

"It is unacceptable, with common sense, to respect banks as sacred cows at a time when a global crisis that started from the banks happens to be sweeping over the world," Orbán argued for MPs. "The bank tax is necessary, fair and effective, because it serves the interests of the country and the people in a very difficult situation." The bank tax is part – item 25 – of Orbán's 29-point program, announced on June 8, which includes spending cuts, reductions in corporate and personal income taxes and limits on the pay of public workers, including central bank President András Simor. The bank levy was the most important measure in the government's strategy to plug a gaping hole in this year's budget. Without the levy and spending cuts at public institutions mentioned in Orbán's 29-point package, the budget deficit would rise to 5% in 2010, far in excess of the 3.8% agreed with the EU and the IMF as a condition for a 20-billion-euro standby loan in 2008. After a landslide victory on general elections earlier this year the new government faced local elections Oct. 3 and was reluctant to impose further austerity measures to narrow the deficit.

What is the Hungarian bank tax all about?

Hungary seeks to raise 200 billion forint (HUF) (EUR 700, US$900 million) through the tax on banks, insurers and other financial-services companies, including some HUF 13bn in revenue from extraordinary bank taxes already in place, to meet the deficit target. Banks, insurance firms and other financial companies will have to pay this amount in two parts on September 30 and December 10 this year. Roughly 130 billion will be due from the banks and 70 billion from other financial institutions. The government, which failed to agree with lenders on terms of the tax, plans to keep it in place for three years. Talks with banks were only to address the issue of how their lion's share of this sum would be levied. The government had suggested to banks that the total assets held by banks and the size of their foreign currency loan portfolios would be used as a basis for calculating their contribution to the levy. In its final version the tax will be levied at 0.5 percent of banks' assets over 50 billion forint at the end of 2009 after the government raised it from an originally planned 0.45

percent with an amendment. That compares with the U.S. plan for a 0.15 percent tax on liabilities and the U.K.'s proposed levy on balance sheets that would peak at 0.07 percent[2].

One day prior to the vote in Parliament a new set of amendments by Economy Minister György Matolcsy took several amendments out of the bill, those that were to ease the burden of the levy on some service providers:

- Thus, insurance companies established after June 1, 2007 should not be exempt from the levy. Tax rate for insurance companies is increased generally to 6.2 percent from 5.8 percent.
- Another abolished preference was intended to help savings cooperatives. According to the final version they should be helped by paying only 0.15 percent of the tax base up to HUF 50 billion and 0.5 over and above, instead the general 0.45 percent pertaining to credit institutions.
- Financial intermediaries will now be exempt from the bank levy, but the tax rate for financial enterprises will be raised uniformly to 6.5 percent from 6.0 percent.
- The base for the levy for investment companies allows the write-off of expenditures on investment service activities. The tax base for companies providing commodities trade services is to allow the exclusion of net sales revenue exclusively from the provision of commodities trade services. Profit from financial services offered by Magyar Posta (Hungarian Post) was made exempt from the tax[3].

Financial sector criticise the Government

The proposed bank tax was vehemently opposed by the financial sector from the start. Some opponents argued that the bank tax, three times larger than any other similar tax planned in Europe, could have a large negative effect on the economy and it would not solve Hungary's fiscal problems. The IMF did not applaud and would like to see durable and non-distortive measures. The European Banking Federation sent a letter to Orbán asking him to reconsider. National Bank of Hungary Deputy Governor Julia Király said that the tax could cause international banks to curtail the activities of their Hungarian subsidies. This could squeeze

[2] Bloomberg Businessweek: Hungarian Lawmakers Approve 'Brutal' Bank Tax Defying IMF, EU, July 22, 2010
[3] Hungarian Investment and Trade Development Agency (ITD Hungary): Bank levy bill amended before final vote, 23 July 2010

lending and slow down Hungary's financial recovery, she cautioned[4]. Hungary's plan for the brutal tax indeed caused a storm in the global business community. There was a general fear that if Hungary introduced a bank tax of this magnitude, Germany, France, the U.K., Romania, Slovakia and others, most recently Croatia would follow suit.

Introducing the bank tax for three years does not mean that there will be no such tax later on, Prime Minister Viktor Orbán said in the closing debate on the package[5]. He said that the government would consider an American-type tax for the future, to replace the new tax which he said was "definitely high" and "could be called aggressive" but "defined in proportion with the problems of Hungary's economy". Orbán responded to remarks by an opposition MP warning that the banks could pass the financial burden of the tax on to their customers, and said that if the banks were in a position to do that, they would not move rocks to prevent the tax from being introduced. Head of the Hungarian Banking Association, Tamás Erdei acknowledged that the banks accepted the bank levy as "unavoidable evil" for 2010, but he urged early talks with the government to reduce the tax from next year on. By 2012 the tax should be lowered to the European level, which he said was one tenth of the new Hungarian levy. He also warned that the high tax could curb lending activities and thus harm the economy[6].

The Government's official position

The Government argues that they are fully attached to the 3.8% budget deficit in 2010 prescribed by IMF and EU which would presumably be one of the best figures within EU.

After G20 summit in Toronto bank tax fits to the international trend and is widely accepted as a means of crisis management which is used by Hungary to achieve the ambitious budget deficit target.

In recent years unlike most of the countries Hungary did not conduct an expansive fiscal policy, did not launch economy boosting projects but introduced several considerable restrictive measures. The Hungarian society have already taken its significant share from the

[4] Robert Hodgson: Gov't pushes ahead on bank levy, The Budapest Times, Wednesday, 7 July 2010
[5] The other bills include a salary cap and a special tax on severance payments for the public sector, a ban on foreign currency-based lending and lifting an earlier ban on brandy distillation, among other measures.
[6] Hungarian News Agency (MTI): Hungary's Parliament approves bank levy, July 22, 2010

process of crisis management which diminishes any further headroom in this regard unless the Government allows the people's further impoverishment at the expense of the country's competitiveness.

The international opponents did not pay enough attention to the 29-item set of economic measures which contains the bank tax. They singled out and criticized the bank tax though it was adopted with dozens of economy boosting measures which more than compensate its alleged negative effect on economic growth. The package's measures also contain a considerably diminished administrative burden on companies, especially on small and medium size enterprises, as well as a second comprehensive development plan which outlines the country's economic policy for the next two decades. The 29-item package – says the Government – boosts and helps to rebuild the economy, promotes enterprises and therefore increases Hungary's regional competitiveness[7].

The financial institutions in Hungary also profited from the stabilizing effect of the vast IMF and EU lawn and agreed that the quick and effective crisis management and the fiscal stabilization require drastic measures. They do find the bank tax acceptable but they contest its excessive amount. The picture would be brighter if the financial institutions themselves had confirmed this but notwithstanding there is some logic in this.

Theoretical insight

The temptation to raise taxes on financial institutions is almost too great to resist. These institutions were largely responsible for the recent economic crisis. While the financial collapse cost millions of people their livelihoods, many top bank executives happily took their bonuses in some cases paid with taxpayer money. And the arrogance and sense of entitlement that oozes from some is beyond offensive. But beyond anger and satisfaction would a tax on financial institutions benefit society? And if so, what form should it take? These are question being asked in the U.S. and in much of Europe as well. The answers, sadly, are not so clear cut.

[7] Hungarian Ministry of Foreign Affairs, Strategic Planning Department: Information on the introduction of the bank tax in Hungary, 10967-1/Adm/KÜM/2010

First question: What is the purpose of a bank tax? Is it to raise money (to reduce deficits, support a bailout fund, or pay for new spending or other tax cuts?) Is it to punish the institutions and their managers for past sins? Is it to prevent future financial madness? Or is it some combination of all three? Not surprisingly, different taxes achieve different results that often conflict with one another. The Hungarian priority was to raise money and not to punish anybody but the rhetoric and its interpretation can be somewhat confusing.

Second question: Who actually pays the tax? For example, a bank tax might hurt those who hold shares in the institution at the time the tax is announced (since it will drive down its stock price). Alternatively such a tax might be paid by depositors in the form of higher fees or lower interest rates. That's not likely to convince banks to change their behaviour.

We are always reminded that a so called "bank" tax should be designed as broadly as possible, and not on specific transactions or on specific institutions. Targeting only encourages the institutions to redefine both themselves and their transactions to dodge the tax. Similarly, any tax should be tied as closely as possible to levies imposed by other countries to limit the ability of banks to locate in low-tax jurisdictions[8].

International background

The International Monetary Fund was asked by the G-20 last year to recommend how to tax bank industry. The IMF – which so vehemently criticized the introduction of the bank tax in Hungary in its present form – suggested considering two different forms of the bank tax to G20-group in April this year. The idea was that banks should pay a general financial stabilisation contribution as well as a tax calculated after profit and employees' wages. A flat rate tax would apply to every financial institution and later those operating with higher risk would pay a higher share. G20 summit in April did not support the IMF's idea on bank tax – channelled into a fund to manage future crises – and the G20 agreement is still pending after the Toronto summit in June.

Group of 20 nations failed to agree on a proposal to impose a global tax on banks that was aimed at making the financial industry shoulder the cost of bailouts, settling instead for a

[8] Howard Gleckman: Does a bank tax make sense?, Forbes, June 4, 2010

common set of guidelines[9]. The issue has proved divisive with the U.S. backing the European initiative, while others – whose banks survived the global crisis intact – opposing it. German Finance Minister Wolfgang Schäuble has lobbied for the bank levy and has said that Europe would go ahead with it on its own, if no wider agreement can be reached. Banks certainly have opposed the effort, warning that the costs may curb credit expansion and economic growth. G-20 finance ministers and central bank governors agreed that governments will take account of each nation's "circumstances and options." The result allows nations such as Australia, Canada, China and Brazil, whose banks suffered less during the global financial crisis, to skip introducing a tax. European countries and the U.S. have advocated the levy. Ministers said they recognized that there's a "range of policy options" open to countries and agreed instead to adopt "principles" that protect taxpayers and reduce the risks of further crises.

G20 as a group did not like the introduction of a unified bank tax in the long run. At the same time they accepted it as a means of crises management when required, and said that the details were to be determined by the state concerned[10]. There remains to be a disagreement within the international financial community that the levied bank tax should be put into a fund and provide a protective umbrella for the financial sector in case of future crisis situations or it should improve those governments' fiscal balance that are compelled to introduce significant stabilizing expenditures throughout the crisis.

By creating its own bank tax, the first in Europe, Hungary established a pattern and it seems quite likely that several other countries will follow suit. Some analysts trying to justify Hungary's step compare it to a freedom fight where the country's economic independence is at stake. From this angle the IMF's routine-like and sometimes inconsequent behaviour could be a subject of criticism but this is another long story...

On the Eve of the June meeting of the European Council German Chancellor Angela Merkel definitely requested member states to take a stand for the introduction of the unified bank and money-market tax. At the Summit – not influenced by the G20-group's decision – Germany, France and the UK suggested in a joint statement introducing a harmonized bank tax, in form

[9] Gonzalo Vina and Theophilos Argitis: G-20 Fails on Bank Tax, Calls for Joint 'Principles' Bloomberg Businessweek, June 6, 2010,
[10] Hugh Jones: G20 scraps plans for universal bank tax, Reuters, June 5 2010

of a unified framework regulation. Britain, France and Germany committed to levying a fee on banks to shield taxpayers from the cost of resolving financial crises[11]. In their joint statement the three countries said financial institutions should make "a fair and substantial contribution" to reimbursing governments for bailing out banks in the wake of the global economic crisis. The countries said they were each proposing their own legislation, but that all would have more or less the same goal. "All three levies will aim to ensure that banks make a fair contribution to reflect the risks they pose to the financial system and wider economy, and to encourage banks to adjust their balance sheets to reduce this risk," read a proposal released by Berlin's Finance Ministry.

The supporting states have somewhat different views on the implementation. France and the UK (similarly to Hungary) would spend revenue from the bank’s tax on financing general government expenditure. Germany, in contrast, prefers to promote the prevention of the future crises i.e. to fund future bailouts. Germany announced the cornerstones of its considered bank tax in March with the aim of preventing future crises, introducing a special kind of precautionary measure. Banks and financial institutions would pay 1.2 billion EUR yearly in a central provident fund that would serve crisis management purposes as well as could be used to assist banks that got in trouble. The amount of the levy varies between 0.01% and 0.04% of the financial institution’s assets depending on how big the assets are. Germany also unveiled an austerity package in June with welfare cuts and new taxes worth 80 billion EUR until 2014. The figure already includes 6 billion EUR from an unspecified banking tax, anticipating 2 billion EUR a year starting 2012.

In a UK view the bank tax would serve to assist in case of a future crisis. The law might enter into force in 2011 and the current plan says that the amount of the levy equals 0.04% of the financial institution’s balance sheets which would be raised to 0.07% from the following year on. Banks with more than 20 billion GBP (24 billion EUR) income will be subject of the compulsory levy. The Government counts on some 2.5 billion GBP extra to the budget. Chancellor of the Exchequer Osborne said in proposing the British bank tax that his nation had decided to go ahead with the move because London believed it was "not reasonable or fair" to wait until there is agreement on the issue from every country in the G-20. The British

[11] Melissa Eddy, Associated Press writers Robert Barr in London and Juergen Baetz in Berlin also contributed: Bank Tax Coming from Germany, France, UK, Associated Press, 22 June 2010

Bankers' Association expressed support for the bank tax in a statement: "The banks are committed to working with the government to ensure new bank levies balance tax raising objectives with the need to keep the recovery moving." The bankers' group also warned that the levy needs to apply to all banks operating in the UK regardless of their nationality: "The UK is a trading nation and we must ensure bank taxes do not hurt our national interests or provide an unfair advantage for other businesses operating here.”

US also plan to create a fund for bank tax revenues. President Obama’s economic team began seeking a bank fee in August 2009, even as the administration was being attacked by critics on the left and right as too cozy with Wall Street. Treasury Secretary Geithner said such a tax would be passed through to customers. The administration now argues that big banks will not be able to pass on the costs of its levy without risking a loss of market share to rivals that are not subject to the tax. Mr. Obama laid down his proposal for a new tax as early as January this year saying he wanted “to recover every single dime the American people are owed” for bailing out the economy. He spoke in some of his harshest language to date about the resurgent financial industry. With both anti-Wall Street sentiment and the budget deficit running high, Democratic leaders on Capitol Hill welcomed the proposal. Republicans were uncharacteristically silent, their instinctive opposition to tax increases apparently checked by their fear of defending big bankers. And the financial industry lobby seemed splintered, with small community banks happily exempted. The proposed tax would apply to bank, thrift and insurance companies with more than 50 billion USD in assets levying them 0.15% on liabilities and would start in the second half of the year. It would not apply to certain holdings, like customers’ insured savings, but to assets in risk-taking operations. The levy would raise an estimated 90 billion USD over 10 years, according to the White House. But it would remain in force longer if all losses to the bailout fund were not recovered after a decade. The Treasury now projects that the losses from the 700 billion USD loan program, which was created in October 2008, could reach 117 billion USD. The White House said that collecting 117 billion USD would take about 12 years. Anyway, the pressure on a future president and Congress to keep the tax in place is likely to be substantial. Administration officials did not outline any provision for having the tax expire once all the money is recouped[12].

[12] Jackie Calmes: Taxing Banks for the Bailout, The New York Times, January 14, 2010

France has not yet revealed concrete ideas on the subject but they also plan to spend the extra money from bank tax to budget expenditures and the government is expected to include a bank levy in its 2011 budget[13]. French President Nicolas Sarkozy and German Chancellor Angela Merkel have released a joint letter they sent calling for the G20 to agree to impose a levy or tax on banks to ensure that financial institutions pick up the cost of any future financial crisis. In addition, they want more work to be done on developing a financial global transactions tax.

Conclusion

The financial sector obviously does not like the idea of the bank tax, at the same time it has to admit that it fits into post-crisis economic realities. Financial institutions and governments both have their valid arguments though their interests are obviously different on the short run. Hungary introduced the tax first because its short-run financial difficulties were big enough to act quickly. The revolutionary step was more or less a must to the Orbán Government. Notwithstanding, it was brave as well since Hungary has been a toy in the hands of the powerful financial organisations, particularly the IMF, for long decades and might still be too weak as a successful independent player in the general financial and economic turmoil. Anyway, Hungary needs ambitious plans and ability to act independently in order to overcome its difficulties. The majority of the Hungarians and some of the media regard the determined steps of the Government as a financial freedom fight against the Washington based all-mighty organisations which paralyse the country's economy thus diminishing its chances for a better future. Well, surely nobody is interested in a lasting conflict. The IMF would like its money back, banks and financial institutions would like to operate and earn huge profits and the Government would like to stabilise the financial situation in order to give the loan back and let the financial institutions operate for the benefit of the country. The upheaval is about the excessive and immediate amount of 200 billion HUF (EUR 700, US$900 million) and there are no further prospective clashes of long term interests.

[13] Karen Maley: Towards a global bank tax, Business Spectator, 23 June 2010