Sharing the Wealth

By Gerard B Lyons
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CENTRE FOR POLICY STUDIES
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Executive Summary

- In recent months, there has been an intense focus on the competitiveness of the City of London. The Government has unveiled a suite of reforms intended to bolster financial services and unleash more capital and investment. Labour, too, have promised to 'unashamedly champion the financial services sector as one of the UK's greatest assets'.

- One of the most obvious ways in which the UK puts itself at a competitive disadvantage is by imposing a 0.5% transaction tax on a wide range of share purchases, in the form of stamp duty on shares.[1] This despite the fact that the UK has long campaigned against such transaction taxes, and none of our major international rivals impose such a tax at such a level.

- In the last financial year, 2022-3, stamp duty on shares brought in roughly £3.8 billion to the Exchequer.[2] However, there is an overwhelming case that this tax is doing more harm than good.

- In 2007, the consultancy Oxera carried out analysis on behalf of the Association of British Insurers, the City of London, the Investment Management Association and the London Stock Exchange.[3] This found that stamp duty on shares was imposing significant costs on individuals, by reducing the value of their savings, investments and above all pensions. It was also resulting in lower share prices and valuations for UK-listed firms, and making the UK a less attractive place to invest.

- The Centre for Policy Studies recently commissioned Oxera to update its analysis. It found that abolishing this tax would likely increase UK GDP and business investment as well as the size of pension and savings pots – as well as likely being mildly revenue-positive for the Government, due to the wider growth and investment it would promote, and the increase in share prices and pension pots. It would also level the playing field with New York, and help increase the number of market participants and retail investors, promoting liquidity.

- In other words, abolishing stamp duty would support retail investing, increase growth, and make the stock market more competitive. It would also end the distortion which makes it cheaper to trade in cryptocurrency and other unconventional instruments than UK equities.

- This would not be 'a tax cut for bankers', or promote a casino culture in the City. It is a move that would benefit anyone with savings or a pension – in other words, the vast majority of Britons.

- Oxera's modelling shows that a permanent increase in GDP of between 0.2% and 0.7% could be expected in the long run, alongside an increase in annual fixed business investment by FTSE All Share index companies of between £2.8 billion and £6.8 billion. It would increase the average pension by more than £6,000. And in the long run it is likely to increase rather than decrease the overall tax take.

- We therefore urge the Government to make abolition of the tax a key priority at the forthcoming Budget, and if not for both main parties to include the policy in their forthcoming manifestos. The analysis shows clearly that this is not a tax on shares – it is a tax on growth.

1 See below for a fuller definition

2 HMRC, 'HMRC tax receipts and National Insurance contributions for the UK (annual bulletin)', Jan 2024. Link

3 Oxera, 'Stamp duty: its impact and the benefits of its abolition', May 2007. Link

Introduction

The Treasury faces endless demands for particular taxes to be cut, or the tax burden as a whole to be lowered. Yet there is arguably no case as compelling or unambiguous as for the abolition of stamp duty on shares.

Introduced in its modern form in 1974, the tax was levied upon the registration of securities (not on transactions per se) at 2%. This was reduced to 1% in the 1984 Budget and 0.5% in 1986. In the 1990 Budget, the then Conservative government announced the tax would be abolished upon the introduction of the London Stock Exchange's new settlements system, Tarus. But Tarus was itself abandoned in March 1993, meaning the tax remained.

Technically speaking, the current form of stamp duty is imposed 'on market participants that are not registered as financial intermediaries' at a rate of 0.5% of the value of purchases of UK-listed equity shares. Transfers of unlisted shares, or securities sold on 'recognised growth markets' such as the Alternative Investment Market (AIM) and the ICAP Securities & Derivatives Exchange (ISDX), are not subject to stamp duty. Additionally, the administrative arrangements vary depending on whether the share transfers take place using a paper instrument (in which case the stamp duty applies if the transaction is more than £1,000) or by electronic means, in which case stamp duty reserve tax (SDRT) applies. Since the introduction of another electronic settlements system, CREST, in 1996, SDRT has taken over as the main tax on share transactions. For the purposes of this paper, 'stamp duty' is an umbrella term for both.

'Peel Hunt describe stamp duty as a 'pernicious tax that is having a material impact on UK equity markets', pointing to the much lower (or nonexistent) levels of the tax in rival markets; the lack of liquidity in the UK; and the growing trend towards UK companies delisting'

Stamp duty on shares has also been heavily criticised. In a recent article, Peel Hunt described it as a 'pernicious tax that is having a material impact on UK equity markets', pointing to the much lower (or nonexistent) levels of the tax in rival markets; the lack of liquidity in the UK; and the growing trend towards UK companies delisting from the public markets.[4]

In its response, the Treasury insisted that 'Stamp taxes on shares are carefully designed to raise revenue to help fund public services – contributing billions each year – without damaging the ability of businesses to access capital or impede on London's position as a global centre for listing companies'.

It is the firm position of this paper that this is no longer true, if it ever was. As the modelling commissioned by the Centre for Policy Studies from Oxera will show, stamp duty on shares is indeed a pernicious and damaging tax. It is time to fulfil that original promise from the 1990s, and dispose of it for good.

4 Peel Hunt, 'Stamp out stamp duty', Feb 2024. Link

The case against transaction taxes

Before we address stamp duty on shares specifically, it is worth pointing out that it belongs to a class of taxes that are generally frowned upon by economists.

A neutral, pro-growth tax system should seek to avoid transaction taxes. By their very nature they distort economic decision-making by, among other things, distorting the allocation of capital in the economy, increasing the cost of capital, reducing the after-tax rate of return, and discouraging mutually beneficial trade at the margin.

To put it as simply as possible, if you tax something, you get less of it – which is one reason why the Centre for Policy Studies has long campaigned against the better-known version of stamp duty, which is levied when people move home.[5]

Transaction taxes, in other words, are bad taxes which diminish growth and hurt living standards. (This is not just the CPS's view – the Mirrlees Review by the Institute for Fiscal Studies is among the many studies to support that position whole-heartedly.)[6] However, they have become a permanent feature of the UK's fiscal landscape.

> **'If you tax something, you get less of it – which is why the CPS has long campaigned against the better-known version of stamp duty, levied when people move home'**

Transaction taxes are attractive to governments because of how easily they can be levied and the low cost of administering them. For example, data from 2001 showed that stamp duty was the cheapest of all taxes to collect, costing the taxman just 0.09 pence per pound raised vs 1.56p for income tax.[7]

More important, however, is the how much money they raise. Given the presence of the City of London, and the extraordinary level of house prices, transaction taxes on houses and shares have become a nice earner for the Treasury. In 2018, they raised revenue equivalent to 0.8% of GDP versus the OECD average of 0.5%. That represented 2.3% of total tax revenue, versus the OECD average of 1.4%.

Proponents of transaction taxes have cited an array of arguments for their use in tax policy. One is that they should be used when the transaction is not always efficiency enhancing – for example, to puncture the froth in financial markets. In this instance, it is argued, a transaction tax can be a useful tool in curbing speculative behaviour and subsequent price volatility, as well as discouraging risky financial activities which help contribute to systemic risks in financial markets.

This logic underlined the case for the 'Tobin tax' on financial transactions in the 1970s, which proposed reducing the volatility of floating exchange rates via a small tax – for example, of 0.1% – levied on every amount exchanged from one currency into another. The idea was that the tax would be small enough to make short-term currency speculation uneconomical, since it impacted on the ability of countries to implement independent monetary policies, without it being a burden on trade.[8]

5 See for example Alex Morton, 'Stamping Down', Centre for Policy Studies, Oct 2019. Link

6 'Tax by Design – The Mirrlees Review', Institute for Fiscal Studies, p.151

7 Inland Revenue, 2001. This figure includes the cost of collecting stamp land taxes. In all likelihood the figure for share transactions alone will be lower, given most transactions on the LSE are electronic, resulting in the deduction being automatic.

8 For a full critique of the Tobin Tax see Charles Goodhart, 'An Alternative to a Tobin Tax', Eurointelligence, Nov 2009

While this argument may have superficial appeal, on closer scrutiny it does not hold up. Subsequent research has shown there is no evidence of a clear link between speculation and volatility.[9] But there is evidence that financial transaction taxes (FTTs) impact incentives to trade and, specifically in the case of stamp duty, reduce the price of the more frequently traded shares.[10]

Despite this, the Tobin Tax and FFTs more broadly gained renewed interest following the 2008 financial crisis. In September 2011 and again in February 2013, the European Commission considered imposing an EU-wide FTT – against Britain's determined opposition – before concluding it was too harmful. The Commission's own modelling at the time showed the baseline scenario of implementing an FTT would lead to a decrease of EU GDP in the long run of 1.76%, while the best-case scenario was still a loss of 0.53%.[11] Moreover, there was no convincing argument for how an FTT could have prevented the financial crisis: as the IMF noted in 2010, an FTT 'does not focus on the core sources of instability', while having significant disadvantages all of its own.[12]

'The Commission's own modelling at the time showed the baseline scenario of implementing an FTT would lead to a decrease of EU GDP in the long run of 1.76%, while the best-case scenario was still a loss of 0.53%'

In fact, it can be argued that FTTs actually penalise sound investment management and create unwelcome investment incentives. For example, an FTT can deter fixed income portfolios from investing in shorter-duration bonds, or deter pension funds from seeking market-neutral returns through long-short strategies (or indeed, any attempt to hedge your market position).

Most proponents of FTTs have therefore shifted to presenting them as a means of gaining additional revenue from the financial sector, which they argue should be taxed more. They argue that the tax is not only efficient but progressive, since the burden falls on the wealthy who hold and trade shares.

But again, these points fall apart under closer investigation. There are far more effective ways of taxing the financial services sector, and indeed no guarantee that those within it would bear the burden of an FTT rather than having it passed on to consumers. More importantly, although stamp duty may appear progressive, the reality is that it depresses UK companies' share prices, in turn impacting everyone's saving and pension pots. On top of this, it increases the cost of raising capital, which in turn impacts investment. This ultimately harms workers who, as a result of a smaller capital stock, are less productive and receive lower wages.

9 Radalj and McAleer, 'Speculation and Destabilisation,' 2005, as cited in Mirrlees

10 Institute for Fiscal Studies, 'Stamp Duty on Shares and Its Effect on Share Prices', 2004. For additional analyses on the impacts of FTTs see Oxera (2012), 'What would be the economic impact on the EU of the proposed financial transaction tax', June, Link; Oxera (2013), 'Analysis of European Commission staff working document on the proposed financial transactions tax', May, Link ; Oxera (2014), 'What could be the economic impact of the proposed financial transaction tax?', May, Link.

11 House of Lords, EU Economic and Financial Affairs and International Trade Sub-Committee, 'Financial Transaction Tax, Oral and written evidence'

12 'Financial Sector Taxation: The IMF's Report to the G-20', IMF, September 2010, p.17

The case against stamp duty on shares

Financial transaction taxes are bad and distortive taxes. Indeed, the UK has consistently opposed the imposition of a Tobin tax at a European level.[13] Which makes it all the more bizarre that we continue to levy our own version of a Tobin tax on many millions of share transactions, at a significantly higher rate.

Of course, there are some differences. Unlike a traditional financial transaction tax, stamp duty only applies to UK shares and therefore must be paid regardless of the location of trading, which means funds are not incentivised to move offshore. It also exempts intermediary transactions and has several reliefs, including for securities transactions by broker-dealers who purchase shares for trading rather than investment, which aims to help create liquidity on exchanges.

‘The financial crisis has been followed by a long period of stagnant growth. One of the chief drivers of this is that Britain has become a low-investment economy’

But even then, there is clear evidence that stamp duty on shares is having a damaging effect.

Back in 2007, the independent consultancy Oxera carried out a major piece of analysis on behalf of the Association of British Insurers, the City of London, the Investment Management Association and the London Stock Exchange.[14]

It found that stamp duty was having an extraordinary array of malign economic effects. These included:

- Reducing the average pension fund by around £6,441 in retirement, increasing to £11,538 for equity-based portfolios.
- Depressing the valuation of UK companies by around 7.2%, or £146 billion
- Depressing annual fixed business investment by FTSE350 companies by anything from £2.7 billion to £6.4 billion
- Depressing GDP by between 0.24% and 0.78%

All these figures, remember, were in 2006/7 prices, so would be 60% higher today.

The report also found that abolishing stamp duty could increase liquidity significantly, and could be either revenue-neutral for the Treasury (given the growth effects elsewhere) or actually bring in more money.

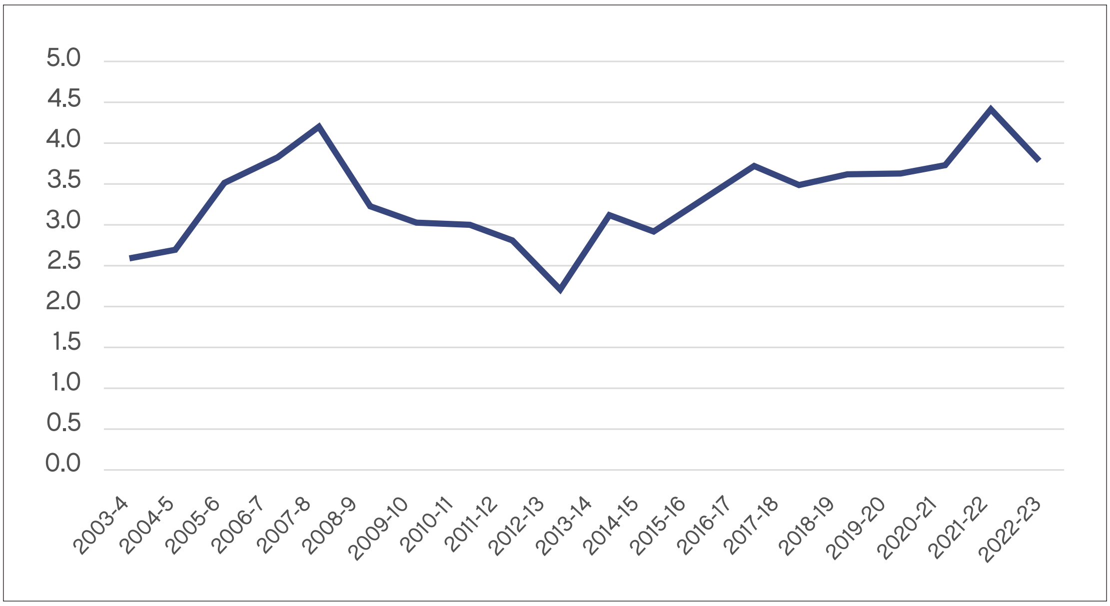
Since that report, concerns about stamp duty – and the competitiveness of the UK's financial services sector – have only grown. The financial crisis has been followed by a long period of stagnant growth. One of the chief drivers of this is that Britain has become a low-investment economy. And one of the causes of this is that there has not been enough capital to invest – in particular, via the stock markets.

You can see some of this in HMRC's figures for stamp duty receipts. In the last financial year, 2022-3, it brought in just under £3.8 billion. This is above the pre-crisis peak – but well below it when you factor in inflation.

13 The Telegraph, ‘David Cameron: I will veto financial transaction tax’, Jan 2012, Link

14 Oxera, ‘Stamp duty: its impact and the benefits of its abolition’, May 2007. Link

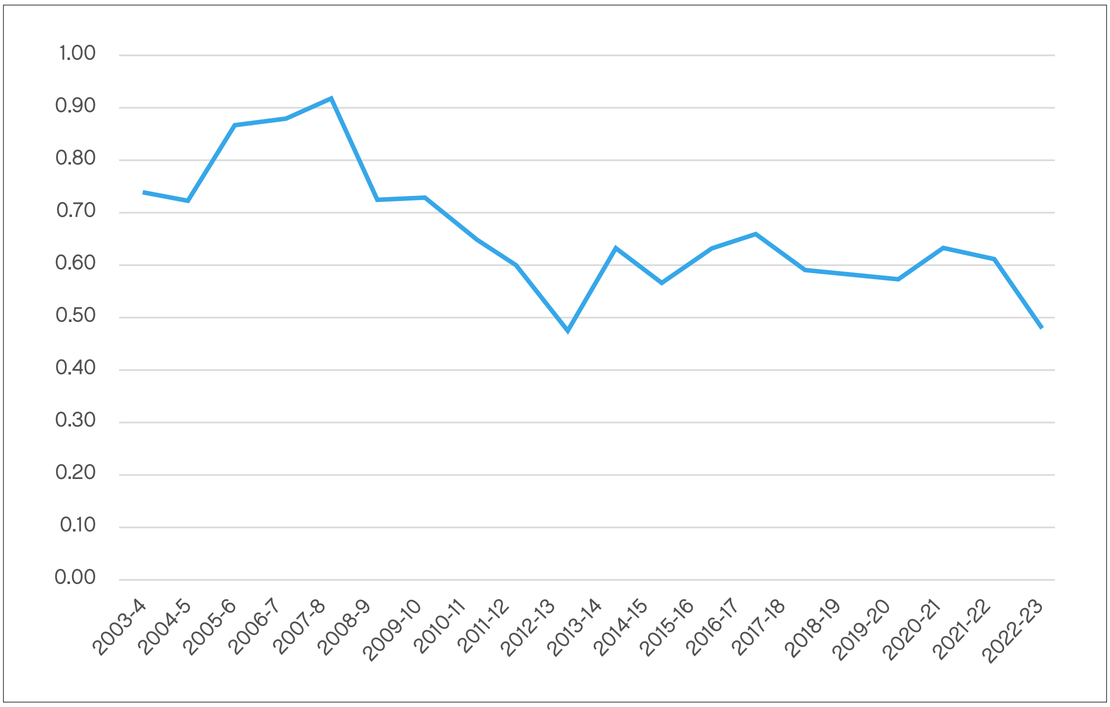
Stamp duty receipts (£bn)



Source: HMRC

A more accurate picture comes if you look at stamp duty on shares as a proportion of overall revenues. As this second chart shows, it has not just remained flat since the financial crisis, but actively fallen. And it is falling because the number and/or value of transactions on that market have been falling, too – exactly the opposite of what we would want from an active, highly liquid stock exchange.

Share of total tax revenue (%)



Source: HMRC

Recently, there has been endless anecdotal evidence of firms being reluctant to list in London, and in some cases actively delisting in favour of New York. Even ARM, one of the few UK-based firms that can be spoken of in the same breath as the US tech firms, chose to list in the US because of the higher valuations on offer there.

In their recent article critiquing stamp duty on shares, Peel Hunt point out that companies equivalent in value to almost 10% of the FTSE All-Share Index will have moved their primary listing away from London, or dropped their London listing, in just the last three years – including JustEat, BHP, Ferguson, Smurfit Kappa and more.[15] Many of these firms have explicitly blamed the lower valuations and lower liquidity in London, which are of course interconnected.

That same report also points out that stamp duty in the UK is set at a much more higher level than in the world's other major financial markets, many of which do not levy the tax at all. It is also worth pointing out that the UK taxes share trading more than multiple other forms of trading, which will naturally result in those forms of trading attracting volume at the expense of UK equities.

Taxes on financial transactions

Ireland	1.0%
UK – shares	0.5%
France	0.3%
Hong Kong	0.3%
Singapore	0.2%
Spain	0.2%
Italy	0.1%
UK – cryptocurrency	0%
UK – ETFs	0%
UK – spread betting	0%
UK – AIM shares	0%
UK – share buyback	0%
US	0%
Germany	0%
France (companies <e1bn mkt cap)	0%
Spain (companies <e1bn mkt cap)	0%
Australia	0%
Spain (companies <e500m mkt cap)	0%

Source: Peel Hunt

Government is of course alive to these issues, and there has been a concerted attempt within the Treasury to enhance the City's competitiveness, not least in the wake of Brexit. There was the UK Listings Review from Lord Hill (a Board member at the Centre for Policy Studies).[16] There was Mark Austin's review of secondary markets, which concluded that getting more retail investors invested in the stock exchange is both an economic opportunity, given their potential as a pool of capital, and a moral good, since means more people have a stake in the economy.[17] The Government launched first the Edinburgh Reforms[18], and then the Mansion House compact.[19]

Increasingly, this is an area cross-party concern, too. The Labour Party recently published its own review of the financial services sector, which promised that 'we will unashamedly champion our financial services sector as one of the UK's greatest assets'

15 Peel Hunt, 'Stamp out stamp duty'

16 UK Government, 'UK Listing Review', March 2021. Link

17 UK Government, 'UK Secondary Capital Raising Review', July 2022. Link

18 HM Treasury, 'The Edinburgh Reforms', Dec 2022. Link

19 HM Treasury, 'Chancellor's Mansion House Reforms to boost typical pension by over £1,000 a year', July 2023. Link

and noted that 'our history as an innovating, industrious, trading nation was built on the foundations of a strong financial sector'.[20] The Centre for Policy Studies also contributed to this debate with our recent paper on reviving retail share investment, 'Retail Therapy'.[21]

Yet amid this welter of reform proposals, there was surprisingly little attention paid to the issue of stamp duty – despite Oxera's 2007 work having pinpointed it as a key contributor to many of the problems being discussed.

We therefore commissioned Oxera independently to redo their analysis – providing, for the first time since the financial crisis, an authoritative estimate of the impact of stamp duty on shares on the City and the economy, and the potential benefits of its removal. This analysis was originally carried out in mid-2022, but had to be shelved due to the political disruption at the time. It has since been revised and updated for publication.[22]

The Oxera modelling finds that the benefits of abolishing stamp duty would not be quite as dramatic now as in 2007. This is down to the globalisation of UK share portfolios, lower share volumes, and the fact both that there are fewer defined benefit pension schemes and that those schemes are increasingly invested in bonds rather than shares. (Which is a problem all of its own for UK growth, and for those saving into such schemes.)

But it still finds that there would be dramatic, and welcome, effects – and, as before, that the benefits of abolition would comfortably offset the costs to the Treasury.

The full findings are set out in the attached document, but we have summarised them here. Again, what is striking is the sheer range of ways in which stamp duty is damaging both individual savings and the economy as a whole.

The impact on pensions

Stamp duty represents an additional trading cost that reduces the size of pension savings available to UK pensioners. Calculating this burden in turn represents the size of the economic benefit that should be realised if it were abolished.

Oxera analysed the two most common UK workplace pension schemes: occupational direct contribution (DC) and direct benefit (DB). The two schemes respectively cover 36% and 36% of all UK employees participating in a workplace pension plan.[23]

Overall, their model found that stamp duty reduces the size of a representative DC pension fund by 1.0%, which is the equivalent of £6,051. For a fund that is more heavily allocated to equities, it reduces the size by 1.2%, or £8,086. DB scheme holders face a lower burden of 0.2% or £1,708, largely due to their heavy allocation to long-term bonds.

Beyond the headline figures, the modelling finds that stamp duty has other malign effects. Because only UK equities are subject to stamp duties, it penalises savers who invest more in domestic equities – precisely the opposite of the Government's intention to promote domestic share ownership, for example via its mooted 'British ISA'.[24]

20 Labour Party, 'Financing Growth', Jan 2024. Link

21 Nick King, 'Retail Therapy', July 2023. Link

22 Oxera has undertaken an update of its 2007 and 2022 studies, relying on the existing and longstanding academic literature and empirical relationships that remain valid for the current context.

23 It should be noted the importance of DC pensions will increase going forward as most DB schemes are closed to new members.

24 Investment Week, 'Jeremy Hunt signals interest in potential British ISA launch – reports', Feb 2024. Link

It should be noted that the model's estimate that 1.0% lifetime stamp duty costs is lower than the result obtained in Oxera's 2007 study.[25] This reflects the globalisation of UK pension funds' portfolios, as well as lower share turnovers. This shift away from owning UK listed companies means funds are less exposed to stamp duty payments. Table 2.2 from the Oxera report demonstrates the sensitivity of DC schemes' stamp duty costs to the share of UK equity inside a portfolio. A portfolio with a 20% UK equity share would have stamp duty costs equal to 0.76% of the total portfolio at retirement – or £4,705. A portfolio that allocated 50% of its assets to UK equity would face stamp duty costs equal to 1.91% of the total portfolio – or £11,778.

Oxera's modelling also showed that the impacts varied greatly depending on the duration of saving, and the frequency with which shares were bought and sold.

Table 2.2 Workplace DC schemes' sensitivity to UK equity allocations

	Proportion of assets allocated into UK equities (%)			
	20%	**30%**	**40%**	**50%**
Total stamp duty payments (£)	3,987	5,974	7,957	9,935
Total fund size at retirement (£)	619,299	618,344	617,392	616,441
Stamp duty cost (£)	4,705	7,061	9,418	11,778
Total stamp duty cost at retirement (%)	0.76%	1.14%	1.53%	1.91%
Reduction in average return on assets due to stamp duty (%)	3bp	4bp	6bp	7bp

Source: Oxera

Table 2.3 Workplace DC schemes' sensitivity to the length of saving

	Investment length (years)			
	20	**30**	**40**	**50**
Total stamp duty payments (£)	416	1,488	4,224	10,715
Total fund size at retirement (£)	124,103	272,657	542,739	1,030,603
Stamp duty cost (£)	468	1,730	4,985	12,619
Total stamp duty cost at retirement (%)	0.38%	0.63%	0.92%	1.22%
Reduction in average return on assets due to stamp duty (%)	4bp	4bp	4bp	4bp

Source: Oxera

Table 2.4 Workplace DC schemes' sensitivity to velocity of trading

	Velocity of trading of UK equity shares (%)			
	0.15	**0.30**	**0.45**	**0.70**
Total stamp duty payments (£)	2,498	4,960	7,389	11,361
Total fund size at retirement (£)	625,064	619,145	613,291	603,672
Stamp duty cost (£)	2,953	5,859	8,718	13,379
Total stamp duty cost at retirement (%)	0.47%	0.95%	1.42%	2.22%
Reduction in average return on assets due to stamp duty (%)	2bp	4bp	6bp	9bp

Source: Oxera

25 In 2007, Oxera estimated that an occupational DC scheme faced a 1.52% lifetime stamp duty cost and a 7-basis point annual return reduction.

The impact on the cost of capital for listed companies

Stamp duty, and other transaction costs, directly impact the gross return that investors require from their investments. If it is assumed that investors require minimum rates of return, net of all taxes and other transaction costs, there is a direct relationship between transaction costs and the required pre-tax return.

Specifically, in any given year, investors receive a final return that is a function of the pre-tax earnings of the company, corporation and personal taxes, and transaction costs. Assuming the riskiness of the security stays the same, investors will want to receive identical final earnings, independent of tax rates and transaction costs. Transaction costs that investors bear in any particular year will therefore directly influence the post-corporation tax return that they require in this year, and hence the pre-tax return that firms need to earn.

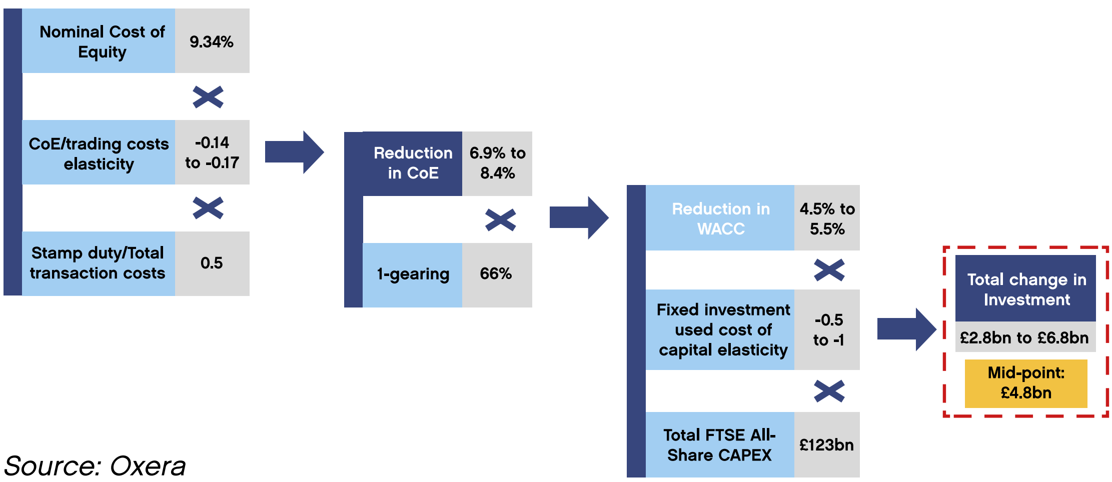
Abolishing stamp duty should therefore result in a significant increase in the valuation of UK listed companies. Specifically, the total UK equity market should expect a one-off increase of 4.0% in valuation, which given the current total market capitalisation of £2.5 trillion, would represent a £99.8 billion one-off capital gain for UK investors as well as one-off capital gains tax boost of £155 million for the Treasury (though obviously this would only be realised as the shares were sold, and depending on whether they benefited from being within an ISA or similar savings vehicle).

This one-off increase is estimated using a methodology from the academic literature, which relates the tax change, the level of velocity and the dividend yield to the changes in share prices by estimating the net present value of all future stamp duty payments.[26]

However, there is another way of measuring the impact of stamp duty: to consider how it affects the cost of equity. A reduction or abolition in the stamp duty rate should likely have a significant effect on the cost of equity of UK listed companies.

The relationship between trading costs and cost of equity is illustrated in Figure 3.1.

Figure 3.1 Benefit of stamp duty abolition on the cost of capital and private investment



Source: Oxera

26 Jackson, P. and O'Donnell, A. (1985), 'The Effects of Stamp Duty on Equity Transactions and Prices in the UK Stock Exchange', Bank of England Discussion Paper No. 25.

The effect on the cost of equity is calculated by building on the elasticity between trading costs and the cost of equity as estimated in academic literature.[27]

Trading costs can be broken down into three main components:

- Commission fees
- Implicit costs (i.e., slippage between the arrival price and execution price)
- Taxes associated with the transaction

Based on Oxera's calculations, the average commission fees per transaction averaged 5 basis points and implicit costs averaged 45 basis points in the UK.[28] Therefore, stamp duties constituted 50% of financial transaction costs when trading UK equity shares. Consequently, assuming the current cost of equity of the UK listed companies of 9.34% in nominal terms (or 7.2% in real terms),[29] the abolition of stamp duty should likely result in a reduction in the nominal post-tax cost of equity of UK listed companies of 6.9-8.4%. This is equivalent to a reduction in the post-tax cost of equity of 0.65-0.79 percentage points.

A reduction in the cost of equity will lead to a reduction in the cost of capital of UK listed companies. Assuming the current average gearing level of UK listed companies is approximately 34%, stamp duty abolition should likely result in a reduction in the nominal post-tax cost of capital of 4.5%-5.5%.[30]

This cheaper funding opportunity could result in an additional £2.8bn-£6.8bn in annual fixed business investment by FTSE All-share companies, with a mid-point estimate of £4.8 billion.

Differences across sectors

One of the most important conclusions of Oxera's original modelling was that abolishing stamp duty would impact on different sectors in different ways – not least because certain shares tend to be traded more frequently, and because certain sectors tend to have different investment intensity, and because some sectors tend to have more firms that are publicly traded (and therefore subject to stamp duty) than others.

To account for the heightened volatility in trading activity due to the pandemic, our new Oxera analysis used five-year average values from 2017-2021.[31]

According to the model, the firms in the retail sector could benefit from a 10.9% reduction in investor required rate of return on equity. The reduction should be more limited for companies in the insurance sector (6.3%) or construction (7.1%).

Added to this, the cost of equity impact of stamp duty on a particular company depends on the amount of stamp duty that investors expect to pay when trading in shares of that company. The impact therefore depends on both the velocity of trading in shares of the company and the proportion of trading that is subject to stamp duty.[32]

27 Domowitz, I. and Steil, B. (2001), 'Innovation in Equity Trading Systems: The Impact on Transaction Costs and Cost Of Capital', in B. Steil, D. Victor and R. Nelson (eds) (2002), *Technological Innovation and Economic Performance*, Princeton University Press.

28 Using data provided by Virtu Financial for the period 2017-21.

29 Oxera (2023), 'Cost of capital for PR24: Final report for Yorkshire Water Services Limited', August, p. 4.

30 Gearing is estimated as the ratio of net debt (total debt minus cash and cash equivalents) to the sum of net debt and the value of equity. Oxera calculations using Bloomberg data.

31 Oxera's calculations are based on data from Datastream and the London Stock Exchange.

32 As a result of the intermediary tax relief, only part of the trading activity in UK listed companies is subject to stamp duty.

Table 3.2 summarises the results at the sector level, based on velocity of trading. Meanwhile, Table 3.3 sets out the average cost of equity impact.

Table 3.2 Velocity of trading subject to stamp duty, 2017-21

Industry	Velocity of trading subject to stamp duty	Industry	Velocity of trading subject to stamp duty
Retailers	0.26	Construction	0.17
Travel & Leisure	0.25	Telecommunications	0.17
Consumer Products and Services	0.24	Insurance	0.15
Technology	0.22	Financial Services	0.15
Chemicals	0.20	Health Care	0.13
Basic Resources	0.20	Food, Beverages and Tobacco	0.13
Industrial Goods & Services	0.20	Energy	0.12
Media	0.20	Banks	0.12
Real Estate	0.19		

Source: Oxera calculations

Table 3.3 Cost of equity impact across sectors[33]

Industry	Cost of equity impact (%)	Industry	Cost of equity impact (%)
Retailers	10.9%	Construction	7.1%
Travel & Leisure	10.4%	Telecommunications	6.9%
Consumer Products and Services	9.9%	Insurance	6.3%
Technology	8.9%	Financial Services	6.0%
Chemicals	8.4%	Health Care	5.3%
Basic Resources	8.3%	Food, Beverages and Tobacco	5.2%
Industrial Goods & Services	8.2%	Energy	5.1%
Media	8.2%	Banks	5.0%
Real Estate	7.7%		

Source: Oxera calculations

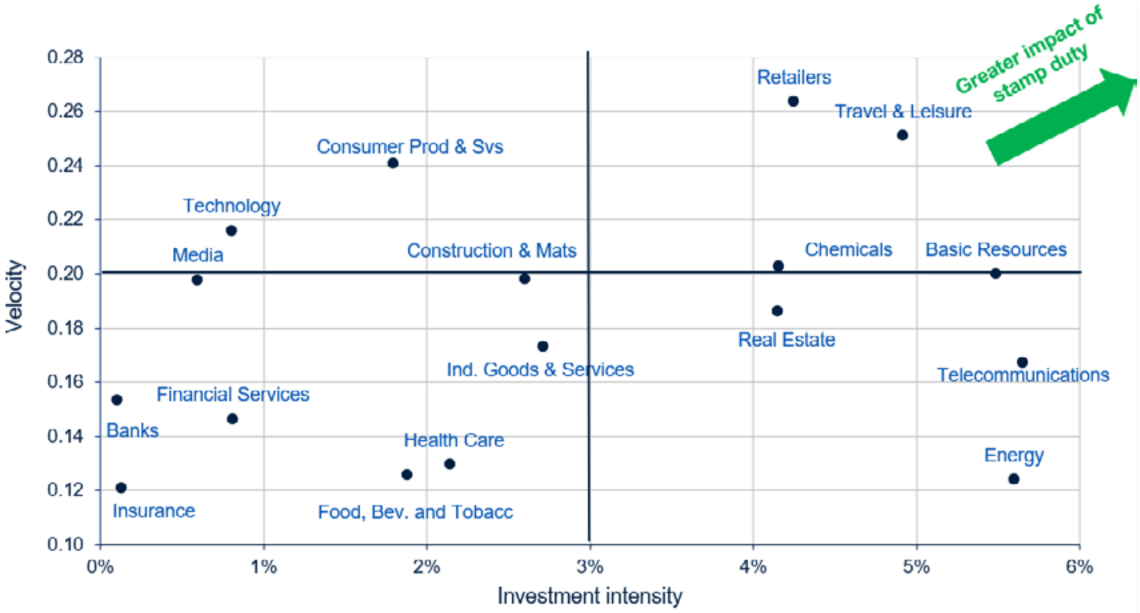
As mentioned above, fixed investment intensity is particularly sensitive to changes in the cost of capital. Consequently, sectors with companies that have high capital intensity are likely to be more affected by stamp duty. Therefore, the distribution of fixed-investment intensity across sectors provides an indication of which sectors are likely to be more affected.

For the purposes of this report, fixed investment intensity was modelled by dividing fixed business investment figures – or capital expenditure data – by the total assets on a firm's balance sheet.

33 The impact of abolishing stamp duty on cost of equity and cost of capital is based on a high-level estimation from past empirical research. The impact of abolishing stamp duty may be limited in cases where stamp duty is not yet priced in by investors into stock returns and company valuations, as well as cases where a company is privately held and/or not subject to liquidity constraints and mis-pricing on the stock market.

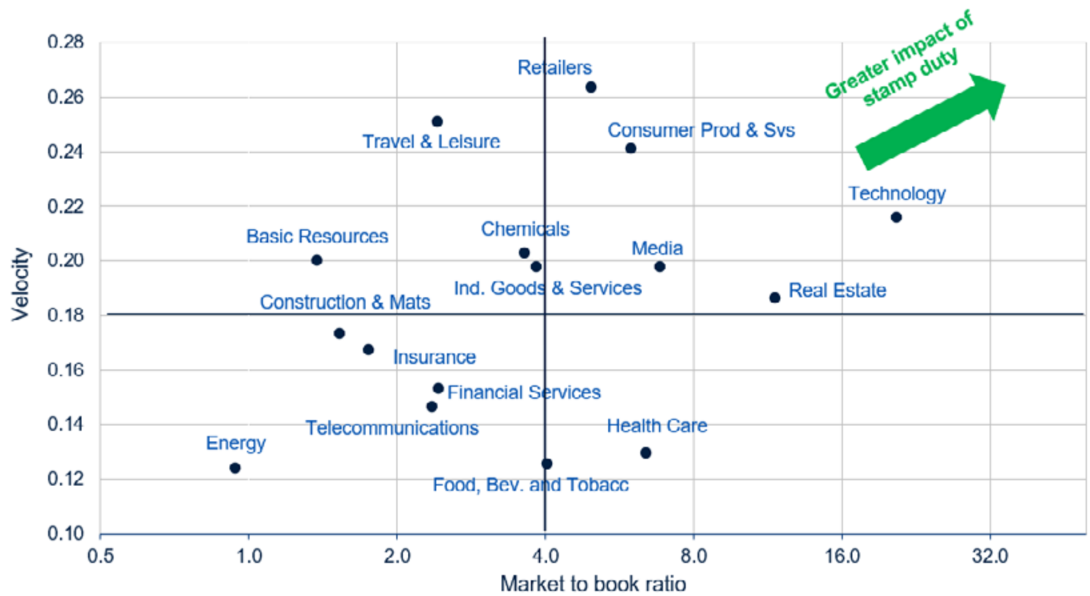
Figure 3.2 illustrates which sectors have both high fixed investment intensity and high velocity of trading. Industries with a high value in both variables are particularly likely to benefit in the event of the abolition of stamp duty. Sectors with high growth potential are also more sensitive to changes in the cost of capital, and are therefore potentially disproportionately impacted by stamp duty. Market to book ratios across sectors provide an indication of which sectors are likely to be more affected, set out in Figure 3.3.

Figure 3.2 Fixed investment intensity and velosity of trading, 2017–21



Source: Oxera calculations

Figure 3.3 Market to book ratios and velocity of trading, 2017–21[34]



Source: Oxera calculations

34 Market to book ratios are presented on a natural logarithmic scale.

The wider economic impact

Abolishing stamp duty would self-evidently be good for the City, and for the millions of savers and pensioners in the country. But it would undoubtedly have a positive impact on the UK's wider economy. This can be illustrated by estimating how it would impact fixed business investment, GDP and the Government's tax take.

Oxera's modelling estimates that abolishing stamp duty would result in:

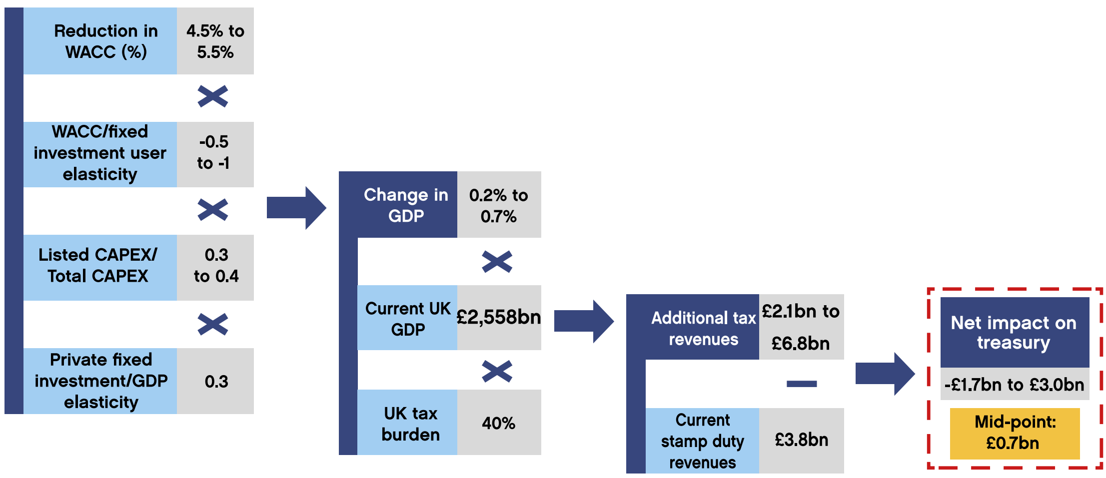
- An increase in the annual fixed business investment of FTSE All Share index companies of between £2.8bn and £6.8bn
- A long-run increase to UK GDP of between 0.2% and 0.7%
- An increase in revenue for the Treasury of between £2.1bn and £6.8bn, the midpoint of which is comfortably higher than the current stamp duty take of £3.8bn

All of these impacts would compound themselves over time, as of course would the benefits to pensioners and savers.

The underlying economic theory here is that by abolishing the tax, the cost of capital for UK listed companies decreases, which in turn likely leads to an increase in fixed business investment. This investment should subsequently likely lead to an increase in GDP. Finally, higher GDP leads to a higher tax take.

This is illustrated with the figure below, although the exact split between different types of tax income is difficult to establish.

Figure 4.1 Impact of stamp duty on the UK economy and Treasury



Source: Oxera

The links between the cost of capital, capital stock and GDP have been assessed in considerable detail in academic studies. There is also a large body of literature surrounding the link between the cost of capital and fixed investment expenditure. While there is a consensus about the negative relationship between the two variables, the exact magnitude is uncertain. Nevertheless, the key strand of literature established a range of elasticities between -0.5 and -1.[35]

35 Hassett, K.A. and Hubbard, R.G. (1996), 'Tax policy and investment', NBER working paper No. W5683; Cummins, J.G., Hassett, K.A. and Hubbard, R.G. (1994), 'A reconsideration of investment behavior using tax reforms natural experiments', Brookings Papers on Economic Activity, 2, pp. 1–74.

As described earlier, the change in cost of capital was estimated using current market and economic data as well as elasticities estimated in the empirical economics literature.[36]

Based on Oxera's calculations, the abolition of stamp duty should result in UK GDP being permanently higher by between 0.2% and 0.7%, although this effect would materialise in full only in the long run. Given current UK GDP of £2.6 trillion,[37] this is equivalent to a permanent increase of £5.2bn and £17.0bn.[38]

'Assuming an overall tax burden of 40%, the abolition of stamp duty in the long run could increase the annual tax take by a mid-point estimate of £4.4 billion, minus the £3.8 billion in existing receipts'

The long-term impact on the Government's tax take can then be estimated by considering the total tax burden relative to GDP. Assuming an overall tax burden of 40%, the abolition of stamp duty in the long run could increase the annual tax take by a mid-point estimate of £4.4 billion, minus the £3.8 billion in existing receipts.[39] Therefore, the modelling suggests it could be significantly more likely to be revenue positive than not.

This would, of course, be dependent on exactly how stamp duty were abolished. The impact of a one-off measure would obviously be different from a phased reduction and abolition, as would the costs – although the ultimate benefits would likely remain the same.

As mentioned above, abolishing stamp duty and the subsequent increase in share valuations should also lead to a one-off increase in revenue from capital gains tax of approximately £155 million, although this would only be hypothetical until the shares were sold.

36 Other important inputs were taken from earlier studies from Oxera (2007) and Bassanini, A. and Scarpetta, S. (2001), 'The driving forces of economic growth: panel data evidence for the OECD countries', OECD Economic Studies No. 33.

37 Source: ONS

38 Bassani and Scarpetta (2001) estimates suggest that it generally takes four to five years for the economic output to come halfway towards the new steady-state output per capita equilibrium following a change in a GDP determinant.

39 These calculations assume that the Government's tax take should increase in line with economic growth. It is however possible that the effective tax rate associated with economic growth driven by increases in fixed business investment could be somewhat different from the overall effective tax rate. Source for the tax burden data: House of Commons Library (2021)

Conclusion

Abolishing stamp duty on shares would benefit all savers, increase business investment, improve the competitiveness of the City and increase economic growth. All things the Government has insisted it wants to achieve.

On top of this, it is very possible that this is one of the few tax cuts that really would pay for itself, due to the impact on the tax take increases associated with increased fixed business investment and economic activity.

> **‘Abolishing stamp duty on shares would benefit all savers, increase business investment, improve the competitiveness of the City and increase economic growth’**

In economic terms, transaction taxes like stamp duty make zero sense. From a competitiveness standpoint, this targeted tax cut would perfectly complement the existing regulatory agenda being pursued to support the City and financial sector – not least by removing a key disadvantage for Britain’s financial services sector compared to other major exchanges.

Given the Government’s commitment to raising economic growth, we therefore urge both parties to abolish the tax at the earliest opportunity. It is bad for savers, bad for growth and ultimately, bad for Britain.

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