European Commission /
Taxation and Customs Union

Innovative financing at a global level

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Plan of talk

- Motivation: Why innovative financing?
- Definition and assessment criteria
- Review of selected instruments in relation to the financial sector
- Conclusions

Why innovative finance?

Political Background

- At its meeting of October 2009, the European Council invited the Commission to examine innovative financing at global level (related to climate and development finance as well as exit strategy)

- In its plenary session of March 2010, the European Parliament adopted a resolution on the taxation of financial transactions

- Increasing international debate on possible sources of finance to support fiscal consolidation, to ensure that financial sector contributes to the cost of past bail-outs and future crisis intervention and to finance provision of global public goods

Why innovative finance?
Need for Fiscal Consolidation

Change in Debt to GDP ratio – EC Autumn 2009 Forecast

140.0%
120.0%
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%

EE BG LU RO DK SK CZ SE SI LT FI LV PL CY NL MT ES AT HU DE EU FR EA UK PT IE BE IT EL

2007 2011

Why innovative finance? Challenges

- **Financial stability**
  The financial sector should contribute to the costs of financial stability.
  Estimated sustainability gap of 6,5% of GDP on average in EU

- **Climate change/ Copenhagen Accord**
  Fast-start of USD 30 billion 2010 to 2012 and the goal of USD 100 billion dollars a year by 2020 by developed countries to developing countries (ca. 7.2 billion for EU)

- **Development**
  Millennium Development Goals (MDGs), Commitments on scaling up Official Development Assistance (ODA) (ca. 50 billion for EU by 2015)

Options

- **Expenditure**
  Reduction in non-productive spending tends to have more long-lasting effects if linked to structural reforms

- **Traditional tax revenues**
  Increases in rates, in tax bases and in efforts to fight tax fraud

- **Review of existing tax systems**
  Reduce existing distortions and improve efficiency.

- **Innovative sources of financing**
  Analysis of economic effects and revenue potential

Innovative financing Issues

- **Definition**
  Public finance that is raised in non-traditional ways; does not include mechanisms that are exclusively private finance

- **Importance of implementation at global level**
  Fair burden-sharing and global political commitment needed; risks of tax evasion by relocation of economic activities or tax bases depending on the innovative instrument considered

Assessment Criteria

1. **Potential to raise revenues:**
   Serious budgetary challenges to be addressed

2. **Effects on efficiency and stability:**
   Internalisation of external costs and benefits ("double dividend")

3. **Effects on equity and income distribution**: Tax Incidence

4. **Administrative and legal aspects**:
   May complicate feasibility

Innovative financing and financial sector

- **Pricing of leverage and risk-taking**
  Tax on certain balance sheets positions of financial institutions, with the revenues being channelled either into a crisis resolution fund (Sweden) or into the budget (U.S.)

- **Financial transaction tax and Currency transactions levy**

- **Taxation of bonus payments**
  Expected to reduce managers' or traders' incentives to take excessive risks (UK, France, Greece)

- **Increase in profit taxation**
  Higher rate or surcharge on corporate income tax in the financial sector, idea: taxation of pure profits

Revenue raising potential

Financial sector:

- Applying Sweden's Stability Fee in the EU-27 could raise more than €10 billion; the US rate applied on all banks irrespective of their size up to €50 billion
- FTT revenue estimates of more than €50 billion worldwide and of about €20 billion for the EU (conservative estimate leaving out derivatives at this stage). With derivatives the revenue estimates are around €300 billion for a global application
- Bonus taxation: around €4 billion if implemented in the whole EU
- Profit taxation: around €4 billion depending on level of surcharge, if implemented in the whole EU

Efficiency and stability Effects

Financial sector

- **Taxing leverage and risk-taking** by financial institutions can foster financial stability by slowing the build up of excessive risk positions in balance sheets;
- **FTT** may actually increase price volatility in specific markets by reducing the number of transactions and liquidity; transactions might be easy to relocate; effects also depend on the microstructure of markets
- **Bonus taxation**: time-limited tax (i.e. one year) would have negligible efficiency effects; long-run tax more likely to reduce risk-taking; but: possibly some relocation of activities to non-taxed countries or areas and to quasi-financial sector.
- **Profit tax**: Partly taxing pure rents; Profit tax only on financial institutions could raise the required pre-tax of profit

Effects on equity and income distribution

Financial sector:

- For most instruments, companies are likely to roll over part of the tax burden to clients, some redistribution effects from bank capital holders (capital loss) via budget to general population. The aggregate effect on relative capital/labour income in some cases unclear.
- Bonus taxation: Some redistribution effects: from high-income earners and bank capital holders (capital loss) via budget to general population.

Administrative and legal Aspects

- **Financial sector:**
- Tax on leverage and risk-taking as well as a surcharge on the corporate income tax easy to administer;
- Concerns about compatibility of FTT with the EU Treaty provisions of free movement of capital and with GATS
- Profit tax: easy to implement since it builds on existing tax systems

Conclusion

- Significant budgetary challenges in the years ahead. Innovative sources of financing can make a significant contribution

- Some instruments can serve multiple purposes

- Importance of global coordination depends upon the type of instrument

- The Commission Staff Working Document can be found at:
- http://ec.europa.eu/taxation_customs/common/publications/com_reports/taxation/index_en.htm