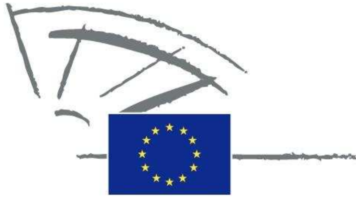

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Committee on Economic and Monetary Affairs

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DRAFT REPORT

on innovative financing at global and European level
(2010/2105(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Anni Podimata

Rapporteur for opinion(*):
..........................., Committee on Development

(*) Associated committee, Rule 50 of the Rules of Procedure

PR_INI

CONTENTS

Page

MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION 3

EXPLANATORY STATEMENT.. 9

MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on innovative financing at global and European level
(2010/2105(INI))

The European Parliament,

– having regard to the conclusions of the European Council of 17 June 2010 and the conclusions of the European Council of 11 December 2009,

– having regard to the minutes of the ECOFIN meeting of 19 October 2010 and to the report to the European Council quoted therein,

– having regard to the Belgian Presidency's programme, in particular the proposals on innovative financing,

– having regard to its resolution of 10 March 2010 on financial transaction taxes – making them work[1],

– having regard to its resolution of 20 October 2010 on the Financial, Economic and Social Crisis[2],

– having regard to its resolution of 22 September 2010 on European Supervisory Authorities[3] and, specifically, its resolutions of 22 September 2010 on the European Insurance and Occupational Pensions Authority[4], of 22 September 2010 on the European Banking Authority[5], of 22 September 2010 on the European Securities and Markets Authority[6], and of 22 September 2010 on macro-prudential oversight of the financial system and establishment of a European Systemic Risk Board[7],

– having regard to the Commission staff working document on innovative financing at a global and European level (SEC(2010)0409) and the Commission Communication on the taxation of the financial sector (COM(2010)0549/5),

– having regard to the proposal for a regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (COM(2010) 0484/5),

– having regard to the Commission Communication on Bank Resolution Funds (COM (2010)0254),

– having regard to the G20 Declaration issued on 15 November 2008 in Washington, the G20 Declaration issued on 2 April 2009 in London and the Leaders' Statement of the G20

[1] Texts adopted, P7_TA (2010)0056.
[2] Texts adopted, P7_TA(2010)0376.
[3] Texts adopted, P7_TA-(2010)0336.
[4] Texts adopted, P7_TA-(2010)0334.
[5] Texts adopted, P7_TA-(2010)0337.
[6] Texts adopted, P7_TA-(2010)0339.
[7] Texts adopted, P7_TA-(2010)0335.

Summit of 25 September 2009 in Pittsburgh,

– having regard to the 2010 IMF report to the G20 on Financial Sector Taxation,

– having regard to the OECD Trade Union Advisory Committee paper entitled 'The parameters of a financial transaction tax and the OECD global public good resource gap, 2010-2020' of 15 February 2010,

– having regard to the 2010 OECD report entitled 'The elephant in the room: the need to deal with what banks do',

– having regard to the Austrian Economic Research Institute (WIFO) study entitled 'A General Financial Transaction Tax: Motives, Revenues, Feasibility and Effects' of March 2008,

– having regard to the Foundation for European Progressive Studies paper entitled 'Financial Transaction Taxes: Necessary, Feasible and Desirable' of March 2010,

– having regard to the Centre for Economic Policy Research study entitled 'Benefits of a Financial Transactions Tax' of December 2008,

– having regard to the report from the Commission - State Aid Scoreboard - Report on recent developments on crisis aid to the financial sector (COM(2010)0255),

– having regard to the Notre Europe study entitled 'An ever less carbonated Union? Towards a better European Taxation against climate change',

– having regard to the outcome document of the High-level Plenary Meeting of the General Assembly of the United Nations "Keeping the promise: united to achieve the Millennium Development Goals" of September 2010,

– having regard to the Declaration of Santiago Seventh Plenary Meeting of the Leading Group on Innovative Financing for Development of January 2010,

– having regard to the Report 2010 of the Committee of Experts to the Taskforce on International Financial Transactions for Development 'Globalising Solidarity: The Case for Financial Levies',

– having regard to Rule 48 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs and the opinions of the Committee on Development and the Committee on Industry, Research and Energy (A7-0000/2010),

A. whereas the unprecedented global financial and economic crisis in 2007 revealed significant dysfunctions in the regulatory and supervisory framework of the global financial system, which can be described as the combination of unregulated financial markets, overly complex products and non-transparent jurisdictions,

B. whereas the spectacular rise in the volume of financial transactions in the global economy

within the last decade – a volume which in 2007 reached a level 73.5 times higher than nominal world GDP, mainly owing to the boom on the derivatives market - is clearly illustrating the growing disconnection between financial transactions and the needs of the real economy,

C. whereas the financial sector is heavily reliant on trading patterns, such as high-frequency trade (HFT), which are mainly targeted on short-term profits and are exposed to excessive leverage, which was one of the main causes of the financial crisis; whereas this has caused excessive price volatility and persistent deviations of stock and commodity prices from their fundamental levels,

D. whereas at the G20 summits held in Washington in 2008 and in Pittsburgh in 2009 an agreement was reached to implement reforms to strengthen financial markets and regulatory regimes and make financial institutions assume their share of responsibility for the turmoil,

E. whereas the main burden of the cost has been assumed thus far throughout the world by taxpayers; whereas there is a growing demand for financial institutions and stakeholders to contribute their fair share to meeting the costs,

F. whereas in the EU in particular the cost of the bail-outs has triggered a subsequent fiscal and debt crisis that has placed a burden on public budgets and severely endangered job creation and welfare state provision,

G. whereas short-termism and speculation on the financial markets against European government bonds were important aggravating factors in the eurozone sovereign deficit crisis in 2009-2010 and have exposed the close links between the inefficiencies of the financial sector and the problems in guaranteeing the sustainability of public finances,

H. whereas this prompted the current debate on European economic governance, a key component of which should be measures to strengthen the coordination of taxation policies in order to safeguard tax justice and bring about a shift in the tax burden from labour towards activities with strong negative externalities,

I. whereas the crisis has highlighted the need to raise new, fair and sustainable revenues in order to ensure that fiscal consolidation is effectively combined with long-term economic recovery and the sustainability of public finances, job creation and social inclusion, which are key priorities of the EU 2020 agenda,

J. whereas the serious budget constraints resulting from the recent crisis come at a time when the EU has entered into highly important commitments at global level, mainly relating to climate-change targets, the Millennium Development Goals and development aid, in particular for climate change adaptation and mitigation for developing countries,

K. whereas on 17 June 2010 the European Council stated that the EU should lead efforts to establish a global approach to the introduction of systems of levies and taxes on financial institutions and called for the issue of the introduction of a global financial transaction tax (FTT) to be explored and further developed,

1. Takes note of the work carried out so far by the Commission, but deplores its obvious reluctance to make concrete proposals and its failure to respond to the call made by Parliament in its resolution of March 2010 for a feasibility study on an EU-based FTT;

2. Emphasises that an increase in the rates and the scope of existing taxation tools and further cuts in public expenditure can be neither a sufficient nor a sustainable solution to address the main challenges ahead at European and global level;

3. Stresses that the main advantage of innovative financing tools, as compared to traditional ones, is their double dividend, as they can at the same time contribute to the achievement of important policy goals, such as financial market stability, and offer significant revenue potential;

Taxation of the financial sector

4. Considers that the introduction of an FTT could help to tackle the growing and highly damaging trading patterns in financial markets, such as short-termism and automated HFT, and curb speculation; stresses that an FTT would thus improve market efficiency, reduce excessive price volatility and create incentives for the financial sector to make long-term investments with added value for the real economy;

5. Emphasises the revenue potential of a low-rate FTT, which could, with its large tax base, yield nearly €200 billion per year at EU level and $650 billion at global level; considers that this would constitute a substantial contribution by the financial sector to the cost of the crisis and to public finance sustainability;

6. Is concerned that there is a high risk that the momentum behind the proposal to introduce a global FTT is about to be lost and deplores the fact that the G20 has so far been unable to promote meaningful joint initiatives on this matter; calls on the G20 leaders to reach an agreement on the minimum common elements of a global FTT;

7. Should no international agreement be reached within the next few months, urges the EU to move ahead with legislative proposals on the introduction of an EU FTT; stresses that a low rate between 0.01 and 0.05% would prevent major shifts in activity towards other, lower-taxed jurisdictions;

8. Points out that some EU Member States have already introduced similar types of transaction taxes with no apparent negative impact;

9. Stresses, further, that the flow of merely speculative transactions to other jurisdictions would not have detrimental effects, but could have the potential to contribute to increased market efficiency;

10. Stresses that within the centralised European market central clearing and settlement services make an EU FTT technically feasible, cheap in administrative terms and simple to implement;

11. Deplores the recent Commission Communication, which comes down against the introduction of an EU FTT not on the basis of comprehensive, evidence-based research,

but on that of the general argument of the competitive disadvantage for the EU economy;

12. Calls on the Commission also to address in its feasibility study the geographical asymmetry of transactions and revenues and the possibility of a graded or differentiated rate on the basis of the asset category, the nature of the actor involved or the short-term and speculative nature of the transaction;

13. Stresses that an EU FTT should have the broadest base possible so as to guarantee a level playing field in the financial markets and not drive transactions to less transparent vehicles; considers, therefore, that all spot and derivatives transactions traded on markets as well as Over-The-Counter (OTC) derivatives should be covered;

14. Welcomes, in that context, the recent Commission proposals on OTC derivatives and short selling which impose explicit central clearing and trading repository requirements on all OTC derivatives transactions, thus making the implementation of this broad-based EU FTT fully feasible;

15. Stresses the importance of comprehensive rules on exemptions and thresholds in order to ensure that the main burden is not transferred to retail investors and individuals;

16. Welcomes the recent proposals from the IMF, supported by the Commission, for a tax on bank assets to allow every country to levy between 2 and 4% of GDP to finance future crisis-resolution mechanisms; believes that bank levies should be proportionate to the systemic significance of the credit institution concerned and to the level of risk involved in an activity;

17. Emphasises, however, that since they are based on balance-sheet positions bank levies cannot take on the role of curbing financial speculation and further regulating shadow banking; stresses, therefore, that bank levies cannot replace or be regarded as an alternative to an FTT;

18. Notes the IMF proposal for a Financial Activities Tax (FAT), as endorsed in the recent Commission communication; stresses that an FAT is a solely revenue-oriented tax tool and therefore has no direct or indirect potential to restore market balance or to curb speculation in financial transactions; emphasises, moreover, that even if they are given the broadest possible scope FATs offer lower revenue potential than FTTs; believes, therefore, that an FAT can only be a complement to an FTT;

19. Is aware of different options for the management of the additional revenues generated by the taxation of the financial sector at both national and European level; is convinced that in order to safeguard the European added value of the aforementioned innovative financing tools a substantial part of those revenues should be allocated to the EU budget to finance EU projects and policies;

<u>Eurobonds</u>

20. Fully supports Eurobonds as a common debt management instrument based on mutual pooling of parts of sovereign debt to safeguard low interest rates; calls on the Commission to move forward with an in-depth impact assessment regarding the feasibility of

Eurobonds;

21. Supports the idea of issuing common European bonds to finance Europe's significant infrastructure needs and structural projects in the framework of the EU 2020 agenda;

22. Considers that in the long term a permanent EU institution competent to issue Eurobonds both to safeguard national bond market stability and to facilitate investment in EU-level projects will have a significant added value; believes that this should be fully investigated in the framework of the current debate on enhanced economic governance;

Carbon tax

23. Stresses that the current taxation model should fully embrace the polluter-pays principle by using innovative financing tools in order to shift the tax burden on to activities which pollute the environment;

24. Supports, therefore, the introduction of a carbon tax on European sectors not covered by the Emissions Trading Scheme as well as a comprehensive revision of the energy taxation directive to make CO_2 emissions and energy content one of the basic criteria for the taxation of energy products;

25. Stresses that both tools have a strong double dividend, providing major incentives to shift towards carbon-free and sustainable and renewable energy sources, on the one hand, and significant additional revenue, on the other;

26. Believes adequate tools need to be found to impose a CO_2 tax on imported products and services in order to rule out competitive disadvantages for the internal market;

27. Believes that a European carbon-added tax along the lines of VAT imposed on every product within the internal market would be the least distortive and fairest tool; suggests as an alternative a Border Taxation Adjustment negotiated within the WTO framework to provide for the imposition of carbon tariffs on non-EU products imported into the internal market;

Financing for development

28. Emphasises that innovative financing for development can help traditional development aid mechanisms to achieve their goals on time; stresses that innovative financing for development should be characterised by diversity of funding, in order to reach maximum revenue potential, but also be fully tailored to each country's priorities, with strong country ownership;

29. Instructs its President to forward this resolution to the Commission, the European Council, the EIB, the ECB and the IMF.

EXPLANATORY STATEMENT

The general framework into which the debate on innovative financing is taking place

The global economic and financial crisis of 2007-2009 has exposed the severe weaknesses in the regulatory and supervisory framework of the global financial system. Financial transactions today are characterised by an enormous rise of volume and by a remarkable discrepancy between the volume of financial transactions and of the underlying needs in the "real world". Moreover new trading patterns such as short term investing and automated high frequency trading have taken a central role in the global financial trends and have led to excessive volatility and risk taking.

It is clear that the financial sector switched to a large extent its role of financing the needs of the real economy to short term profits through operations that can severely affect market prices.

In EU the financial crisis was followed by a fiscal crisis in 2009-2010, an important factor of which was the excessive and in several occasions unjustified pressures of the markets against national bonds. It was once more short term and highly speculative transactions that were in the middle of that crisis and have underlined the clear connection between inefficient financial regulatorion and supervision and the sustainability of public finances.

The problems caused by that behaviour of the markets were fully impacted on public finances and citizens around the world, when in the outburst of the crisis trillions of dollars were spent on bailing out the main players of the financial sector that were "too big to fail".

The economic costs of the crisis are still to be fully assessed, since apart from the bailing out costs, the crisis has led to an important slowdown of the global economy and has triggered unprecedented levels of government deficits (according to 2010 OECD data the estimated size of fiscal consolidation is projected at 300-370 billion dollars for the next years).

However, what is clear by now is that the world and EU can not afford and should not allow for another crisis of a similar magnitude. The first reactions at the global level (in the G20 summits that followed the outburst of the crisis) but also at EU level were to go forward with concrete regulatory and supervisory changes that would help shape a safer financial environment and would prevent similar crisis in the future.

However this is not enough: taxpayers are assuming today the main burden of the cost of the crisis not only through direct contributions but also due to rising unemployment, falling incomes, reduced access to social services and rise in inequalities.

In order to provide with comprehensive and integrated responses to the crisis we need new tools which can:

- Curb speculation and reinstore the main role of the financial sector towards covering

real economy's needs and supporting long term investments;

- Guarantee a fair distribution of the burden especially amongst the key financial players;
- Create new additional resources to meet the key global and European challenges such as climate change and development goals and to achieve a long term higher growth in the framework of the EU 2020 strategy.

The choice of innovative financing - The "Double Dividend"

In order to deal with those three targets we need tools that can assume multiple roles.

Traditional taxation tools, focused only on revenues raising, are not sufficient. Moreover cuts on public expenditures and further increases of the rates of existing taxation can not be a sustainable response given the current demand for boosting global and European growth. We need to opt for a stimulus rather than a single approach austerity strategy and in that sense the debate on innovative financing tools should become our key priority.

Innovative financing tools can address today's challenges as they can assume at the same time a regulatory role (for example by reinforcing market efficiency, transparency and stability) and a revenue raising role (by generating important and new resources for EU and national budgets).

The allocation of the additional revenues

EU and national policy makers are focusing their interest on the revenue potential deriving from those new financing tools. However what we should not forget is that only after an agreement on the implementation of an innovative tool, can we really discuss in concrete regarding the new revenues.

There are different arguments and choices to be made regarding the management of those revenues. However in principle we should agree that in order for those innovative financing tools to have the added value we need them to have, a substantial part of those revenues should be allocated at a EU budget to finance EU projects and policies.

One should not forget that the critical point today is to reach an agreement and implement innovative financing tools, the allocation of revenues coming in second.

Taxation on Financial Sector

Contrary to any other industry providing goods and services to final consumers, the financial sector is largely untaxed. In EU there is a basic VAT exemption approach for all basic financial activities. At the same time financial sector's activities stand for 73.5% of

global GDP and therefore their tax exemption a major market distortion.

The idea of a tax on financial transactions (FTTs) -already suggested since 1930s - presents an important advantage especially today in the aftermath of the crisis. By placing an FTT we can curb speculation and stabilize markets, we can create incentives for long term investments, we can put an audit trail on every transaction and thus reinforce transparency and we can make the financial actors assume their fair share for the cost of the crisis. Moreover with the revenues potential of a 0.05% FTT being nearly 200 bn € in EU and 650 bn $ at global level, it can decisively contribute to the need for new and sustainable resources.

The global crisis has revealed the need for global responses and therefore the introduction of a global scale FTT is of course the best possible way to move forward. However and in spite of the progressive views of the G20 summits right after the crisis, there seems to be today a retreat towards "business as usual". If we leave this momentum go by and opt for inaction, we will be unable to draw the right lessons of the crisis and deem our economies for yet another hit in the years to come.

EU is today the biggest financial market of the world and as such its own interest is not to "hide" behind the reluctance of its international partners but to lead the way both at global and European level.

The long anticipated impact assessment by the Commission on the feasibility of an EU FTT - already asked by the EP since March 2010 but absent from the Commission's Communications of April and October 2010 - should be presented as soon as possible. It should constitute the first step towards legislative proposals for the introduction of an EU FTT. At the same time this will provide a clear mandate for the EU to put pressure at G20 level.

Regarding the argument on competitiveness risks possibly caused by unilateral introduction of an EU FTT, the recent examples of UK stamp duty or of the Hong Kong FTT show that a well designed FTT can efficiently deal with that risk and avoid transaction flaws. Moreover investors are not going to be keen to opt for less known or opaque jurisdictions if the transaction costs are low. The main actors tempted to "migrate" will be the extremely short term traders (which will assume the main burden), but even if parts of short term transactions fly outside EU, this could be of an added value for the European economy.

The main features for an EU FTT should be:

- Low rate, between 0.01% and 0.05% so that there is no important risk for transaction flaws;
- Broad tax base including every type of transaction, in order to enable a level playing field and avoid flaws towards less regulated parts of the financial sector;
- Clearly defined exemptions and thresholds, taking into account the needs of the retail and small investors.

Additionally to FTT the current debate on the taxation of financial sector includes two other instruments: bank levies and Financial Activities Taxes (FATs).

Both of them seem to have the support from IMF and the Commission. However apart from the fact that the revenue potential of both is lower than the one from FTT, the main characteristic in both cases is the absence of the "regulatory value". Neither bank levies nor FATs can directly contribute to curbing speculation and reinforcing market stability and efficiency. Bank levies are based on balance sheet positions leaving outside the transactions in shadow banking systems, which are the ones presenting the main leverage risks. FATs constitute taxation on the profits deriving from financial transactions but irrespective of the "quality" transaction itself.

Therefore they can in no way constitute an alternative to a FTT. Each one however can assume a supplementary role:

Bank levies as a tool to finance national crisis resolution funds in the banking sector, ensuring that in the case of a next crisis its costs will be bared by the sector itself.

FATs as an additional tool in the case that after introducing FTT the rents of financial sector continue to be excessively high and taxation equity principle would imply additional tax.

Eurobonds

The idea for a common European financial instrument that will enable a common debt management through the mutual pooling of parts of national sovereign debt has been debated for a long time. However in the light of the recent financial and fiscal crisis, the need for reinforcing economic governance and putting in place permanent tools and mechanisms became more clear than ever.

In that sense it is today more appropriate than ever to go through with an in depth impact assessment fully analyzing the different potentials vis a vis Eurobonds.

At the same time the idea of Eurobonds has been also linked to financing key projects and infrastructures at EU level. This is an additional potential that we can welcome and ask to be included in the abovementioned feasibility study.

Given that Eurobonds are now assuming a diverse role it would also be of added value to fully assess the possibility to establish a permanent EU institution under the responsibility of which Eurobonds issuing and managing will fall.

Taxation of the energy sector

Sectors like labour are currently assuming the main tax burden and sectors with important and negative externalities in the contrary are not assuming their fair share. Apart form the financial sector, the sector of environmental polluting activities falls in that category. We

need to put in force the principle "the polluter pays" in order to enable the shift of tax burden from labour to polluting activities.

Currently the EU ETS covers only specific parts of the European economy and mainly industrial sectors. At the same time the Directive on Energy Taxation makes no differentiation between low and high CO2 content services neither does it use the criteria of energy content or energy efficiency. This neutral approach constitutes a disadvantage regarding energy efficient fuels, carbon free activities and products and is completely inconsistent with the main EU climate change goals.

Some Member States have already dealt with this inconsistency at national level by introducing a carbon tax. Although we should welcome such initiatives, the need for a coordinated EU approach is substantial for the functioning of the internal market.

We need to revise the current Energy Taxation Directive in order to include the criteria of CO2 emissions and energy content. Moreover in order to safeguard the competitiveness of the EU internal market, different options should be fully envisaged regarding non EU products entering internal market that do not comply with those criteria. Negotiating a Border Taxation Adjustment in the framework of WTO can be an option. However the most comprehensive way out would be to put in place a common EU Carbon Added Tax levied on every product in the European market.

However what should be fully taken into account is that neither option should be to the detriment of vulnerable consumers neither lead to new forms of energy poverty. The recent example of the French constitutional court rejecting the proposal for a carbon tax on the basis it was placing overwhelming burden on households, is a clear sign that any proposal should be well balanced and safeguard a fair transition period.

Taxation for Development

Development aid policies such as Millennium Development Goals can use the abovementioned innovative tools as revenue raising sources. At the same time there are possibilities for specialised innovative financing tools linked only to development policies such as the recent Commission's proposal for a Global Climate Change Financing Mechanism in favour of the most vulnerable and poorest developing countries and the air tickets levies. In either case what is important is to safeguard strong country ownership and full alignment to each country’s priorities.