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# Towards an Innovative Financing Mechanism for Sustainable Development: Reviving International Financial Transactions Tax (IFTT) on the G20 Agenda\*

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**Abstract:** SDGs and climate action evidently require staggering amounts of external finance. The global community has found it challenging to keep the commitments on development finance. Given overstretched budgets and fiscal constraints, new and innovative sources of financing are needed. International Financial Transactions Tax (IFTT) can be a new and substantial source of revenue for climate action. New estimates made by the authors and reported in this Brief suggest that, even at a very marginal rate of 0.05%, IFTT could yield annual revenues worth US\$ 650 billion, roughly equivalent to three and a half times the annual flows of ODA. Besides resources for climate action, IFTT could also provide another global public good by helping curb the volatility and the disruptive consequences of short-term capital flows. In that context, this policy brief makes a case for reviving IFTT on the G20 Agenda of the current presidency and proposes a way forward.

## The Challenge

Achieving the SDGs and pursuing climate action will require staggering amounts of external finance. An independent analysis jointly commissioned by the Egyptian COP27 and the British COP26 presidencies has concluded that annual investments in climate action in developing countries (other than China) need to increase immediately from US\$ 500 billion in 2019 to US \$1 trillion by 2025 and to US\$ 2.4 trillion by 2030 for delivering on the Paris Agreement and the SDGs.<sup>1</sup> Furthermore, it was estimated that only about half of these investments could be financed internally by domestic public and private sources and an additional US\$ 1 trillion or so annually would need to come from external sources. Estimates by other organisations suggest that resource requirements of many poorer countries could

be of the order of up to 10% of their GDP.<sup>2</sup> By creating incomes and jobs, improving air quality and public health, and reinforcing energy security, the green transition supported through these funds is expected to transform 'net zero' to 'net positive.'<sup>3</sup> However, a failure to fund this transition and the achievement of SDGs could have devastating consequences for the planet. The funding constraints explain not only why most developing countries are at a great distance from achieving the SDGs, but also why the achieved progress has been reversed in several targets. The poly-crisis comprising the Covid-19 pandemic, the food and energy security challenges resulting from the Ukraine war, and the debt crisis, is threatening to push 175 million people back into extreme poverty.<sup>4</sup>

The global community has found it challenging to keep its development finance

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**commitments.** Despite repeated promises over the years, the collective commitment of allocating 0.7% of gross national income (GNI) as overseas development assistance (ODA) first made way back in the 1970s has never been fulfilled except by a handful of countries. In the spirit of ‘common but differentiated responsibilities’ (CBDR), developed countries also committed to a collective disbursement of US\$ 100 billion per annum at COP15 and reiterated this commitment at successive COPs. Developed countries have failed to honour this commitment, eroding the trust of the developing world on such promises.<sup>5</sup>

Given overstretched budgets, new and innovative sources of financing are needed for climate action and the implementation of the SDG agenda. In the context of stretched budgets of governments in developed (and developing) countries, fiscal space for scaling up external financing seems unavailable. Therefore, the focus of different proposals for climate finance is on augmenting the capital base of the multilateral development banks (MDBs), harnessing private savings, engaging philanthropies, and encouraging public-private partnerships. Some proposals involve the introduction of an international emissions tax on shipping and fossil fuels,<sup>6</sup> and reducing the costs of external borrowings for developing countries.<sup>7</sup> All of these proposals are urgent and their potential benefits need to be tapped. Even if tapped fully, however, they will still be inadequate to meet the growing need for resources dedicated to climate action aiming at a net-zero future. Additional new, innovative and perpetual sources of finance would be needed. International Financial Transactions Tax (IFTT) could be one such innovative source.

### The G20’s Role

Bringing together the world’s largest economies, G20 is uniquely positioned to advance consensus on new and innovative sources of finance such as IFTT to drive climate action and the SDGs agenda in developing countries. This Policy Brief makes a case for reviving IFTT on the G20 agenda for a discussion on its relevance in the changed context since 2011, when it was first discussed by the grouping. New estimates computed for this brief suggest that IFTT could emerge as

an evergreen source of revenue that supports SDGs and climate action. The G20 needs to contemplate on the relevance of IFTT in the context of current realities, including its role in moderating the volatility caused by short-term capital flows. G20 leaders have addressed matters about global taxation and have recently endorsed the global 15% minimum corporate tax on multinational companies at the Rome Summit in 2021. It is now time to advance the agenda for augmenting climate and development finance through IFTT, as summarised in the following paragraphs.

### Recommendations to the G20

The G20 should consider IFTT as a new and substantial source of revenue for climate action. IFTT can serve as the new perpetual source of revenue that supports SDG and climate action targets in developing countries while hurting no one. Initially proposed by Nobel Prize-winning economist James Tobin as a small tax on foreign exchange transactions that “throw(s) some sands in the well-greased wheels of international capital markets,” the so-called Tobin tax has been discussed widely over the past nearly five decades and has generated a lot of support.<sup>8</sup> Although Tobin proposed IFTT to curb volatility in exchange markets through short-term capital flows and currency trading,<sup>9</sup> it has substantial revenue potential.

Our new estimates suggest that even at a very marginal rate of 0.05%, IFTT could yield annual revenues of around US\$ 650 billion. With global foreign exchange transactions exceeding US\$ 7.5 trillion per day (in April 2022, as per the Bank of International Settlements),<sup>10</sup> computations presented in this brief show that even a marginal tax of five basis points (0.05%) would yield US\$ 900 billion annually. This rate is only half of the ten basis points originally proposed by Tobin). Even if the levy of IFTT were to be followed by a 25-33% decline in the volume of transactions, it would still yield between US\$ 603-675 billion annually, amounting to about three and a half times the current level of ODA flows. Given the so-called ‘prisoner’s dilemma’ inherent in the implementation of such a tax, it is most effective when applied globally. However, the scope, coverage and rate of the tax could be determined in a manner that optimises revenues. This proposed tax

would be a perpetual and significant source of revenue, without being a burden on the fiscal space of any government and hurting none but speculators.

**IFTT's ability to curb volatility in financial markets is an additional global public good.** The G20 should not lose sight of the objective underlying Tobin's original proposal—i.e., curbing volatility in financial markets. Given globally integrated capital and financial markets, the impact of monetary policy implemented in developed countries tend to spill over to emerging markets and adds to global volatility. For instance, quantitative easing (QE) resorted to by the Western world following the Global Financial Crisis (GFC) led short-term capital chasing returns to flow to emerging markets, inflated stock-market valuations and resulted in exchange rate appreciations. However, the boom was followed by a sharp correction in the valuations as QE tapered in 2013. The once-booming emerging markets soon became the 'fragile five'.<sup>11</sup>

To support the government stimulus programme in the wake of the Covid-19 pandemic, another iteration of QE was initiated by the Federal Reserve (Fed) on 15 March 2020 by lowering short-term interest rates to zero and resuming large-scale purchases of treasury securities. The European Central Bank followed it up with a €750 billion Pandemic Emergency Purchases Programme. Abundant and virtually free money in the West was once again chasing returns in the emerging markets. This chase led to the build-up of asset bubbles with the Indian Sensex rising by 135%, Korean Kospi by 111%, Russian TRSI by 97%, Taiwan TVSE by 94%, Brazil IBOV by 79.4%, and Indonesian JCI by 54% by autumn 2021.<sup>12</sup> QE which began to be tapered from early 2022 in response to rising inflation in the US and Europe has been inducing volatility in exchange rates and stock exchanges in emerging markets. Thus, IFTT's ability to moderate harmful speculation and tame boom-bust cycles could possibly be an important 'incidental benefit' of the new source of climate finance.<sup>13</sup>

**Changed context since 2011 demands a reconsideration of IFTT by G20 leaders.** IFTT has been on the G20 agenda since the GFC. Following a proposal made by Microsoft Founder Bill Gates, the G20 leaders, at the 2009 Pittsburgh Summit, had agreed to consider the

case for IFTT, especially in view of its potential to curb the volatility caused by short-term capital flows and to raise resources for poorer countries in the aftermath of the GFC. The 2011 Cannes Summit, however, failed to endorse the IFTT proposal, despite strong support from President Nicolas Sarkozy of France, and other European leaders. In view of the critical need for financial resources to counter the existential threat posed by climate change, IFTT needs to be back on the G20 agenda and be supported by the G20 leaders.

The change in circumstances since 2011 warrants bringing IFTT back on the agenda. While the need for climate finance becomes more urgent by the day, limited fiscal space in developed countries dampens the prospects of plugging shortages of finance. The combined effects of the Covid-19 pandemic, the inflationary spiral stoked by the Ukraine war, food and energy security challenges, and the debt crisis, have stretched budgets in both developed and developing countries. Over the past decade, the world has also suffered highly disruptive consequences of boom-bust cycles following monetary policy changes in developed countries—from the 'fragile five' of 2013-14 to the ongoing volatility in financial markets. IFTT has the unique ability to curb volatility while generating resources required for climate action. Given that it has been on the agenda in the past and a lot of analysis and discussion has already taken place, IFTT seems like a proverbial 'low-hanging fruit' waiting to be plucked.

**Technology makes IFTT easy to implement.** In the past, some concerns have been raised on the feasibility of implementing and collecting a tax on international transactions. However, as argued by Stiglitz (2009), with modern technology, the IFTT is much more feasible today than a few decades ago.<sup>14</sup> Furthermore, IFTT is akin to the securities transactions tax that has been implemented at the national level by several countries including India, France, Italy, the UK, and Hong Kong. A cleaner, more generalised, and administratively efficient version of the Tobin tax or IFTT could involve taxing all foreign exchange transactions, whether they are trade-related or capital-market-related. Tobin (1996) had suggested that IFTT could be collected either by the

International Monetary Fund (IMF) or the Bank of International Settlements (BIS), or both.<sup>15</sup>

**IFTT is a progressive and equitable tax.** Short-term funds circulate several times in the week if not within the day. IFTT ends up taxing short-term more than long-term funds, thereby discouraging their flow.<sup>16</sup> IFTT is progressive as it taxes the speculators and brings revenues that would help foster climate action and SDGs, leaving no one behind.<sup>17</sup>

**IFTT has been supported by many leaders and experts over time.** Besides Tobin himself, IFTT has received the support of numerous renowned economists and policymakers over time, including Joseph Stiglitz, Jeffrey Sachs, Avinash Persaud, Stephany Griffith-Jones and Larry Summers (1989).<sup>18, 19</sup> Global business leaders have also lent their voice in support of IFTT, Gates being one of them. It has also been supported by Chancellor Angela Merkel, Vice-President Al Gore, and Parliamentarian Nancy Pelosi.<sup>20</sup> Among other political leaders supporting the IFTT features President Sarkozy of France who, at the conclusion of the Cannes Summit of G20 Leaders (2011) remarked that “I remain convinced (the tax) is possible... that it is indispensable financially given the crisis and that morally it is absolutely necessary.” Prime Minister A B Vajpayee of India said in 2003, “We know that unstable capital flows can severely disrupt developing economies. There is less

ready acceptance of the idea that such flows should be regulated by an international levy. I believe this is a reform whose time has come.”<sup>21</sup> A number of calls have been issued over time in support of IFTT including by the United Nations,<sup>22</sup> and as many as 1,000 economists<sup>23</sup> and opinion-makers besides NGOs.<sup>24</sup> The latest support has come from the Finance Ministers of countries who are members of the Vulnerable 20 (V20) comprising 58 of the world’s most climate-threatened developing countries- at the bloc’s Ministerial Dialogue held in Washington DC on 16 April 2023.<sup>25</sup>

**In view of its relevance to the current circumstances, the G20 leaders may consider reviving IFTT on the agenda of the Finance Track.** An Expert Group can be established to assess the feasibility of IFTT and work out the modalities of its implementation in the current context. The Brazilian Presidency can take it forward to its logical conclusion.

The upcoming G20 Summit has a historic opportunity to signal support for reconsidering the long-pending agenda of IFTT that could help not only to create a perpetual source of finance for climate action and SDGs, but also to curb the disruptive consequences of volatile short-term capital flows. IFTT could be another landmark multilateral effort initiated by the G20, perhaps among the most laudable of all.

## Endnotes

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