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Financial Transaction Taxes for climate change and development

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New and innovative sources of financing are urgently required to address the growing and global challenges of climate change, biodiversity loss, poverty and social injustice. Financial transaction taxes (FTTs) are one of the few sources of financing that can, if designed properly, provide sufficient funding to address all these global problems, as well as contribute to national budgets and repay the debts remaining from the global financial crisis. FTTs may also help prevent future crises, by reducing incentives for financial speculation that provide no social benefits. Different kinds of FTTs have already implemented at the national level in many developed and developing countries, either to raise revenue or to curb speculative financial flows, or both.[1]

Finding the finance to tackle pressing global challenges

At the UN Climate Conference (COP 15) in Copenhagen in December 2009, developed countries committed to mobilize US$100 billion a year by 2020 for climate change actions in developing countries. However, to date there has been little progress towards agreement on how to generate these funds. Certainly traditional sources like transfers from developed country treasuries can get us part-way there, but there are limits to how much funding can be reliably generated by depending on annual budgeting processes. Developed countries are unwilling to make new commitments to increasing the amount of their taxpayers money they send overseas, especially when most of them are facing ballooning deficits because of the financial crisis. Most developed countries have failed to deliver on existing commitments to increase overseas aid to 0.7% of GNI, and there is little room for confidence that they would deliver on even greater commitments for climate action, even if they were willing to make such commitments.

But financing must be found, if we are going to reduce global greenhouse gas emissions to levels that will avoid a climate catastrophe and provide the resources to allow developing countries to adapt to those impacts that have become inevitable. The need is especially pressing for those countries and populations most vulnerable to the impacts of climatic disruptions they played little or no role in causing. WWF estimates that the new and additional public resources required by developing countries to adopt a low-carbon development pathway and to adapt to the impacts of climate change will amount to at least US$160 billion annually on average over the five year period of 2013-2017[2] and rise to around US$200 billion annually by 2020. Only with this amount of public finance, will it be possible to leverage the much greater level of

[1] IMF Working Paper, Fiscal Affairs Department. *Taxing Financial Transactions: Issues and Evidence*. Prepared by Thornton Matheson. Authorized for distribution by Victoria Perry, August 2010. See also: *Raising Revenue: A review of Financial Transaction Taxes throughout the world*. A report for Health Poverty Action and Stamp Out Poverty by Daiana Beitler of Just Economics, September 2010.

[2] The Copenhagen Climate Treaty by members of NGO Community, Version 1.0 narrative, pages 47-48.

private investments required – in the order of US$500 billion to US$1 trillion annually. With growing public deficits, industrialized countries will need to explore and establish innovative financial mechanisms to find the public revenues to fill the gap.

Mobilizing the resources now to make the required investments in adaptation and mitigation will avoid rapidly escalating costs in the future, which could soon make staying below 2°C virtually impossible. Inaction could cost up to 20% of global GDP by 2050.[3] According to the World Bank, everyone is better off if developed countries mobilize financing to pay the costs of ambitious mitigation actions in developing countries now. "Developed countries have the means and incentives to transfer enough finance to non-Annex I (developing) countries to make them at least as well off by receiving transfers and scaling up their mitigation efforts immediately".[4]

Financial transaction taxes as part of the solution

International financing is crucial. Various options are being discussed to generate the resources required including a number of innovative sources. These include sources which embody the polluter pays principle and provide incentives for undertaking mitigation actions, including levies or emissions trading mechanisms to address maritime and aviation emissions, and auctioning emissions allowances. Such measures should be implemented as soon as possible, but to generate sufficient funding, other sources will be needed as well, especially in the current environment when implementation of carbon pricing measures and the ambitious national and global caps required to ensure generation of sufficient revenue are highly uncertain. A tax on financial transactions is a sensible and feasible option that can deliver at scale and provide a large share of the needs of developing countries for climate finance.

A financial transaction tax (FTT) could be levied on all financial market transactions involving stocks, bonds, foreign exchange and derivatives (futures and options). By keeping the level of taxation low, long term investments and borrowing would not be measurably affected but the tax would impact on those that buy and sell a lot of financial products on a regular basis. Ordinary consumer transactions such as payments for goods, paychecks and ATM withdrawals would not be subject to the FTT. Such a tax ideally needs to be agreed and coordinated globally to create a predictable and sizeable source of finance and to close potential loopholes for tax evasion. If a global comprehensive FTT is not possible in the short term, countries and regional blocs can take a stepwise approach and adopt a tax on currency exchanges in the first instance, extending to a broader global FTT later.

Scale of potential revenues: According to the Austrian Institute for Economic Research, a global transaction tax of 0.1% could yield between US$410 billion and US$1060 billion a year.[5] The North-South Institute estimates that a levy of 0.005% on currency transactions on all major currencies in dealer markets would yield US$33 billion a year. A tax of 0.005% on the Euro and British pound would yield US$16.52 billion annually and the same rate of tax on the US dollar alone would

[3] Stern, Nicholas (2007). The Economics of Climate Change: the Stern Review. Cambridge and New York: Cambridge University Press.
[4] The World Bank. World Development Report 2010: Development and Climate Change. Washington, D.C.
[5] European Commission Staff working document, SEC(2010)409 final "Innovative financing at a global level", page 21.

yield US$28.38 billion every year.[6]

Using these revenues for global public goods: The potential scale and predictability of global transaction taxes is such that the income could be used to finance public goods, including, for example, climate, biodiversity, poverty eradication, development and health - global challenges that are closely linked to each other. If the tax is able to raise several hundred billion dollars annually, a portion of the revenue generated could flow to national budgets and at least half of the revenue generated should be earmarked to support public goods, development and climate change in developing countries. An FTT can provide a sound and stable source of revenue to meet the commitments of developed countries towards developing countries.

Applying fairness and equity principles: It is estimated that the financial crisis, resulting largely from poorly regulated financial markets, has caused major setbacks in the development prospects for many developing countries through declining financial flows, reductions in trade and lower levels of remittances. The cost to the budgets of sub-Saharan African countries was more than US$50 billion in 2009 and at least 50 million more people were trapped in absolute poverty.[7]

An FTT will shift the tax burden from the general public and the most vulnerable communities to the financial sector, which has benefited from globalization and light regulation. The cost of direct support to the financial sector through bank bailouts and stimulus packages, estimated to be as much as 2.7% of annual GDP for the G20 countries, has imposed an extra tax burden on many citizens.[8] The impacts of an FTT on long-term savings and investments would be very limited and much more equitable than consumption taxes.

To achieve their full potential, FTTs should be implemented at the global level, and cover all significant markets and trading activities. This can be done in full conformity with the principal of common but differentiated responsibility and respective capabilities, by ensuring that the FTT is revenue neutral for developing countries with no responsibility to pay. The revenue collected from financial transactions attributed to those countries can be returned to the countries directly, and only revenue attributed to the economies of developed countries (perhaps according to agreed criteria or thresholds) will be used for global public goods like climate change action and meeting the Millennium Development Goals (MDG).

Putting the FTT into practice: Recent studies, including by the IMF, show that an FTT is technically feasible and affordable. Money would be collected through a simple and efficient electronic tag on existing electronic settlement systems automatically transferring the tax to the relevant tax offices, and making tax avoidance difficult. Some forms of FTT already exist in many countries. The UK has successfully levied a 'stamp duty' of 0.5% on national stock transactions, which raised £4.2 billion in 2008 without harming the attractiveness of the London Stock Exchange. Furthermore the cost of collecting this tax is small - around 0.21 pence per pound collected in contrast to 1.24 pence for income tax and 0.76 pence for

[6] Schmidt, Rodney; (2007) The Currency Transaction Tax: Rate and Revenue Estimates, The North-South Institute, p. 9.

[7] ODI Briefing Paper 54, September 2009. The global financial crisis and developing countries: taking stock, taking action.

[8] IMF 2010, A fair and substantial contribution by the financial sector, Interim report for the G-20; Meeting of G-20 Ministers, April 2010, p.2.

corporation tax.[9]

The USA, Austria, Greece, Luxembourg, Poland, Portugal, Spain, Switzerland, China, Singapore, Brazil and India have all implemented some type of domestic FTT.

Political decision-makers must step up

The following are some near-term opportunities for leaders to support FTTs:

- **The Advisory Group on Finance** (AGF) which was set up by the UN Secretary General Ban-Ki Moon to explore innovative sources of finance should come up with a wide range of options at the needed scale, including a strong recommendation for a FTT. The AGF should propose a roadmap with some practical advice that political decision-makers can use for rapid implementation.
- **A UNFCCC COP decision on finance** should be adopted at the climate negotiations in Cancun in December 2010, which establishes a process under the UNFCCC for consideration of innovative sources of finance including an FTT, leading to decisions on particular sources by the meeting in South Africa in 2011**.** These sources shall provide resources to be channeled through the Climate Fund under the UNFCCC.
- **The G20 summits** in Seoul, South Korea this year, and France next year should pave the way towards the implementation of an FTT, advocating an FTT as a source of finance for climate and development in its communiqués. The 60-country Leading Group on Innovative Financing for Development has proposed a narrow FTT[10], focused only on currencies, which France has committed to raising for discussion at the G20 during their presidency in 2011.
- **Individual countries and regional blocs** (eg the EU) could take the lead right away by implementing a national or regional FTT, on currency exchanges or on other financial instruments. Countries and institutions which have given support for an FTT which would raise revenue for global public goods include the European Parliament, the UK, Germany, France, Austria, Belgium, Japan, Brazil, Indonesia, Mexico and Chile. Some prominent economists such as J. Stiglitz, N. Stern, J. Sachs, and G. Soros, and a growing civil society movement including health, development, environment NGOs and trade unions also support an FTT.[11]

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[9] European Commission staff working document SEC(2010)409 final, page 25.
[10] Leading Group on Innovative Financing for Development. 2010. Globalizing Solidarity: The Case for Financial Levies. Report of the Committee of Experts to the Taskforce on International Financial Transactions and Development. http://www.leadinggroup.org/IMG/pdf_Financement_innovants_web_def.pdf
[11] For a more comprehensive list of supporters of FTTs, see: http://www.cepr.net/documents/ftt-support.pdf