FINANCIAL TRANSACTION TAXES: A TOOL FOR FIGHTING WALL STREET EXCESSES AND RAISING TAXES FAIRLY

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As we dig our way out of the 2008-09 economic disaster created by casino capitalism, one idea for bringing some measure of control over speculative financial practices that is gaining worldwide support is to impose a tax on financial market transactions. In its basics, the idea of a financial market transaction tax is very simple. It would mean that financial market traders would pay a small fee to the government every time they purchased any financial market instrument, including all stock, bond, options, futures, and swap trades. This would be the equivalent of sales taxes that Americans have long paid every time they buy an automobile, shirt, baseball glove, airline ticket or pack of chewing gum, eat at a restaurant or have their hair cut. The financial market transaction tax would also be equivalent to the taxes that are already incorporated in the price of state lottery tickets. Casino owners in Las Vegas, Atlantic City and elsewhere also already pay high tax rates for the privilege of operating their establishments.

The financial transaction tax can be used to address two distinct but equally important concerns. First, the tax would discourage financial market speculation simply because it raises the costs—and thus reduces the profit opportunities—for speculators. But assuming the tax rate is not set high enough to shut down financial market trading altogether, the tax could also be a large new source of tax revenues. The tax rates could be also be adjusted depending on whether the primary aim was either to shrink speculative market trading, to raise revenues, or to hit a sweet spot that achieves both aims to some meaningful degree.

Rising Political Support for Financial Transaction Taxes

In November 2009, Congressman John Larson, the fourth-ranking Democrat in the House of Representatives, introduced a proposal to tax derivative transactions. At the same time, Congressmen Peter DeFazio and Ed Perlmutter have proposed taxing all stock trades, as well as options, futures, swaps and credit default swaps. Treasury Secretary Geithner has already made clear that the Obama Administration opposes the idea. But support is strong among labor unions and other progressive constituencies.

In Britain, Adair Turner, Chair of the United Kingdom Financial Services Authority, supported the idea of global taxes on financial transactions in August 2009, warning of the ongoing dangers of a "swollen" financial sector paying excessive salaries for activities of questionable social value. Turner's statement was then followed in November by the endorsement of British Prime Minister Gordon Brown, who argued in behalf of a speculation tax that would be applied in all the advanced economies.

It is important to recognize that the various proposals now being advanced in both the U.S. and U.K. by no means represent exotic flights into uncharted policymaking territories. In fact, financial transac-

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tion taxes have been a common-used and generally effective policy tool through the world. Roughly forty countries are either operating now with some version of such a tax or have done so in the recent past. This includes Japan, Germany, Italy, France, China, Brazil, India, South Africa, Chile as well as the UK itself. Even the United States has long operated with a small transaction tax whose revenues, to this day, finance the operations of the Securities and Exchange Commission.

Moreover, in the aftermath of the 1987 Wall Street crash, such a tax or similar measures were endorsed by then House Speaker Jim Wright, then Senate Minority Leader Bob Dole, and even the first President Bush. Variations on the idea have been introduced in Congress fairly regularly in subsequent years, without ever having passed into law. Two of the leading economists who worked in the Clinton Administration, Nobel Laureate Joseph Stiglitz and Lawrence Summers, wrote persuasively on behalf of such a tax in the late 1980s. Summers disavowed the idea soon after joining the Clinton Treasury, becoming instead a major supporter of the deregulation agenda of the Clinton years. Summers is now President Obama's chief economic advisor in his role as Director of the National Economic Council, and appears to remain opposed to the idea he once supported.

How Financial Transaction Taxes Works

The technical features of a trading tax are fairly simple. For stocks, the seller could be charged, for example, 0.5 percent of the sale price, which is the amount suggested by Former House Speaker Jim Wright when he floated the idea in 1987. In the case of bonds, the tax would be proportional to the bond's duration, at a rate of 0.01 percent per year. Thus, the tax on selling a thirty-year bond would be 0.3 percent, and a tax on a fifty-year bond, 0.5 percent, The tax would be adjusted on a comparable basis for derivative financial instruments. Brokers would be responsible for collecting the tax from the sellers at the time of sale. Since there are already reporting requirements with the IRS, this would entail very little additional administrative apparatus.

A trading tax of this size would have virtually no impact on anyone who bought an asset and did not promptly resell it for a quick profit. If someone bought shares of stock at $50 and sold them 10 years later at $100, this trading tax would be 50 cents per share (0.5 percent of $100), on a $50 capital gain (i.e. bought at $50, sold at $100).

On the other hand, a 0.5 percent tax would seriously reduce the profit prospects for short-term speculators. It is not uncommon for speculators to buy a stock or other financial asset, hold it for a day or even hours, then resell it for a small gain. If someone bought a share for $99 yesterday, then sold it for $100 today, the transaction would net a $1 capital gain, a good return on a one-day investment. But the tax in this case would again be 50 cents, wiping out half the earnings from the trade.

A financial transaction tax at a 0.5 percent rate on stocks and scaled appropriately for other instruments is not high enough, acting on its own, to adequately discourage speculation and channel credit to productive purposes. A tax at this rate would be most effective as one measure among several others within a broader package of new regulatory measures. One could use the tax, on its own, to dramatically cut financial speculation. That would only entail raising the tax rate until the point where traders see little incentives to trade at all. But the aim of the tax should not be to shut off the financial market

trading altogether; and if that were the aim, full nationalization of the financial markets would probably be a more effective approach than a confiscatory trading tax.

At the same time, the securities trading tax has the unique feature that even if it is set too low to dampen speculation, the revenues generated from the tax would provide major fiscal benefits at a time when new sources of government revenue are badly needed. Working with 2007 figures, I estimate that a 0.5 percent tax on stock trades and the sliding scale described above for bonds and derivatives would raise on the order of $350 billion if trading did not decline at all after the tax was imposed. By this estimate, even if trading declined by 50 percent as a result of the tax, the government would still raise $175 billion. This figure is roughly equal to the entire Iraq war budget for 2008. It could be major source of funding for a new government jobs initiative. Crucially, the funds would be raised on progressive basis. The tax would fall on Wall Street speculators, who are almost entirely upper-income people.

Would Traders Flee to Global Tax Havens?

One of the arguments that is often made in opposition to the financial transaction tax is that, in today's globally-integrated environment, financial market traders could and would avoid paying the tax simply by moving their activities to countries that do not charge any taxes. Gordon Brown raised this concern in his own endorsement of the idea of the tax. He argued that for the financial transaction tax to work effectively, all the world's major economies would need to impose the tax in a coordinated international initiative.

In fact, establishing the tax in all the major economies would make it easier to administer in each country. Each country would also benefit through having this policy tool in place to both discourage speculation and raise revenues. At the same time, at least in the case of the United States, the tax could operate effectively within the U.S. even if other countries did not concurrently agree to implementing an equivalent tax. The key here would be for the U.S. law to stipulate that unless the taxes were paid on each and every transaction, the transactions would not be recognized as having been effectuated legally in U.S. courts. There would be very few instances in which financial market traders would be willing to sacrifice the protections of the U.S. legal system simply to avoid paying a small tax on their securities trading.

Other technical challenges would also emerge in properly implementing the tax. But such problems will not be insurmountable, just as they have not been in the many other countries in which the tax has operated successfully.

The major obstacles to the successful implementation of a financial transaction tax in the United States are not technical but political. Predictably, the Wall Street titans are vehemently opposed. Despite being themselves the main culprits causing the 2008-09 global financial meltdown, and despite having been rescued from the consequences of their excesses through a U.S. taxpayers-funded bailout, the Wall Street titans continue to exercise tremendous political power, in both the Obama Administration and among Republicans. Implementing the financial transaction tax would be one important tool for forcing these high-rollers to pay for cleaning up the mess they created. More broadly, the financial transaction can make major positive contributions towards forcing the financial markets away from the logic of the casino and towards longer-term commitments for promoting job creation and productive investments.